

1995

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Recommended Citation

Preston D. Wigner, *The United States Supreme Court's Expansive Approach to the Federal Arbitration Act: A Look at the Past, Present, and Future of Section 2*, 29 U. Rich. L. Rev. 1499 (1995).

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COMMENT

THE UNITED STATES SUPREME COURT'S EXPANSIVE APPROACH TO THE FEDERAL ARBITRATION ACT: A LOOK AT THE PAST, PRESENT, AND FUTURE OF SECTION 2

I. INTRODUCTION

The Federal Arbitration Act ["FAA"] was enacted in 1925 to ensure the validity and enforcement of arbitration agreements in contracts involving maritime transactions or interstate commerce.¹ Intending the Act to be a simple method by which an opportunity would be given to enforce written arbitration agreements,² Congress enacted what has become a confusing and controversial statute.³ Because of the absence of an in-depth discussion regarding the scope and applicability of the Act,⁴ Congress placed unintended burdens upon the courts to decipher congressional intent. Of particular concern to the courts was the authority by which Congress enacted the FAA.

Section 2 of the FAA establishes that certain agreements to arbitrate contract disputes shall be "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equi-

1. Arbitration Act of Feb. 12, 1925, ch. 213, 43 Stat. 883 (codified at 9 U.S.C. §§ 1-208 (1988)) [hereinafter the Act or the FAA].

2. See H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924); 65 CONG. REC. 1931 (1924).

3. Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 HOFSTRA L. REV. 385, 386 (1992-93).

4. *Id.*; see also Julius H. Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265 (1926).

ty for the revocation of any contract.”⁵ Congress’ intent in drafting section 2 of the FAA was to create legislation that would “place . . . [arbitration agreements] upon the same footing as other contracts, where [they] belong.”⁶ However, many questions regarding section 2 were not addressed by Congress. For example, Congress did not specifically state under which constitutional provision the FAA was enacted. Congress also failed to provide a standard by which to determine whether a contract “evidences a transaction involving commerce.”⁷ These questions have been addressed by the lower courts and, to some extent, the United States Supreme Court.

The Supreme Court began analyzing section 2 of the FAA thirty years after it was enacted.⁸ Over the next forty years, the Court greatly expanded the application of the FAA to contracts containing arbitration agreements.⁹ The Supreme Court expanded the FAA to apply in state courts in 1983 when it held that section 2 of the FAA preempts state laws that hold arbitration agreements unenforceable.¹⁰ Despite the expansive view taken by the Supreme Court in addressing the scope of section 2 of the FAA, it was silent on issues relevant to interpreting the Act. The Court had never expressly established a standard by which to interpret the “evidencing a transaction involving commerce” language of section 2 of the FAA.¹¹ In 1995, the Court was given the opportunity to do so in *Allied-Bruce Terminix Co. v. Dobson*.¹² It not only decided which standard to apply, but it also addressed the authority upon which the

5. 9 U.S.C. § 2 (1988). This section provides:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

6. H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924).

7. 9 U.S.C. § 2 (1988).

8. *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198 (1955).

9. *See infra* part III.A-E.

10. *Southland Corp. v. Keating*, 465 U.S. 1 (1983).

11. 9 U.S.C. § 2 (1988).

12. 115 S. Ct. 834 (1995).

FAA was enacted and the Act's preemptive powers.¹³ But was the Court correct in its decision? How was it received by Congress, legal commentators, and the lower courts? And what would be the impact of *Allied-Bruce Terminix* on arbitration and arbitration law across the country?

This comment answers such questions by discussing the path of prior holdings the Court travelled to reach its decision, and evaluating the validity of the *Allied-Bruce Terminix* holding. Part II gives the background and history of arbitration and the FAA. It also outlines the critical issues raised by the language of section 2 of the FAA. Part III discusses the Supreme Court's analysis of these critical issues through the enactment of the FAA to the *Allied-Bruce Terminix* decision. Part III also shows how the United States Supreme Court has expanded the reach of the FAA through its decisions but has left its opinions about other issues ambiguous. Part IV discusses the *Allied-Bruce Terminix* decision as it addressed these issues. Part V analyzes the *Allied-Bruce Terminix* decision. This comment then reviews the reaction to the *Allied-Bruce Terminix* decision by Congress, the lower courts, and the legal commentators. The comment ends with a discussion of the possible effects the *Allied-Bruce Terminix* decision will have on arbitration and arbitration law across the country.

II. BACKGROUND AND HISTORY OF ARBITRATION AND THE FAA

Arbitration is defined as "a process of dispute resolution in which a neutral third party (arbitrator) renders a decision after a hearing at which both parties have an opportunity to be heard."¹⁴ These decisions are usually binding upon the parties as per their written agreement. Within the past few years, parties have dramatically increased their use of arbitration to resolve a variety of disputes.¹⁵ This increase in arbitration has

13. See *infra* part IV.

14. BLACK'S LAW DICTIONARY 105 (6th ed. 1990).

15. The number of security cases that have been submitted to arbitration has increased 250% since the stock market crash in 1987. G. Richard Shell, *Arbitration and Corporate Governance*, 67 N.C. L. REV. 517, 521 (1989). The number of labor cases submitted to arbitration has increased by 70% since 1972. Linda Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV.

been attributed to "[t]he high cost, delays, and uncertainties of litigation."¹⁶

The benefits of referring a dispute to arbitration rather than litigation are numerous. Arbitration's informal process relative to litigation makes it cost efficient. The informal nature of the process "enhances the behavior of courtroom participants . . . [and] diminishes the adversarial nature of dispute resolution by encouraging arbitrating parties to work closely together in an effort to seek common solutions."¹⁷ Arbitration procedures also offer confidentiality, whereas a public trial will ultimately disclose the identities of the parties and the details of the dispute.¹⁸

Arbitration is not a new alternative to litigation. In fact, it has been used to solve disputes since the days of ancient Greece, when "traveling wise men, for a fee, would act as ad hoc arbitrators."¹⁹ In medieval times, it was widely, if not exclusively, used for resolving business disputes.²⁰ However, arbitration lost favor with the English courts and was met with judicial hostility.²¹ This judicial hostility has been linked to the fact that English judges were paid fees based upon the amount of cases they decided.²² The judges found that arbitration infringed upon their livelihood. Common law hostility towards arbitration was adopted by the American courts.²³ The courts were slow to change, but growing industrialization increased the frequency of business disputes and lessened the hostility towards arbitration.²⁴

1305, n.7 (1985).

16. Hirshman, *supra* note 15, at 1305, n.7.

17. David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of its Scope*, 61 U. CIN. L. REV. 623, 625 (1992).

18. *Id.*

19. John C. Norling, *The Scope of the Federal Arbitration Act's Preemption Power: An Examination of the Import of Saturn Distribution Corp. v. Williams*, 7 OHIO ST. J. ON DISP. RESOL. 139 (1991).

20. Cohen, *supra* note 4, at 266.

21. *See* Volt Info. Sciences Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 474 (1989).

22. Pierce, *supra* note 17, at 6251.

23. H.R. REP. NO. 96, 68th Cong., 1st Sess., 2 (1924).

24. Norling, *supra* note 19, at 139.

A. *History of the FAA*

To codify this changed view of arbitration, Congress began drafting the United States Arbitration Act to ensure that arbitration agreements in contracts would be protected and enforced as valid contract provisions. An important marker in the promulgation of the FAA was the 1924 United States Supreme Court decision, *Red Cross Line v. Atlantic Fruit Co.*,²⁵ which upheld New York's recently passed arbitration law. By validating a law compelling arbitration, the Court opened the door for Congress to pass similar legislation. Congress followed the Court just a year later when, on February 12, 1925, President Coolidge signed the United States Arbitration Law.

B. *Scope of the FAA*

Section 2 is the substantive provision of the Federal Arbitration Act.²⁶ It makes "valid, irrevocable, and enforceable" written provisions calling for arbitration in any "maritime transaction or a contract evidencing a transaction involving commerce," except where there are "such grounds as exist at law or in equity for the revocation of any contract."²⁷ "Commerce" is defined generally as it is in the Commerce Clause of the United States Constitution.²⁸ When the transaction or contract does not fall within this definition, or that of "maritime transactions,"²⁹ the Act will not apply.³⁰ Although it is suggested

25. 264 U.S. 109 (1924).

26. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1982).

27. 9 U.S.C. § 2 (1988).

28. The FAA defines "commerce" as:

. . . [c]ommerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.

9 U.S.C. § 1 (emphasis added). The Commerce Clause reads: "To regulate commerce with foreign nations, and among the several states, and with the Indian tribes. . . ." U.S. CONST. art. I, § 8, cl. 3.

29. The FAA defines "maritime transactions" as "charter parties, bills of lading of

that most contracts will be covered by the Act,³¹ in practice, the broadness of the Act depends upon the scope given to it by the courts.³²

Section 2 was drafted to make "valid, irrevocable, and enforceable" arbitration agreements in contracts involving commerce.³³ Legislative intent was to enact a statute making "valid and enforceable [sic] agreements for arbitration contained in contracts involving interstate commerce. . . . The remedy is founded also upon the Federal control over interstate commerce and over admiralty. The control over interstate commerce reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce."³⁴ Clearly, Congress had the authority to regulate and control interstate commerce.³⁵ However, Congress also noted that "[w]hether an agreement for arbitration shall be enforced or not is a question of procedure . . . and not one of substantive law."³⁶ Congress was equally capable of "prescrib[ing] the jurisdiction and duties of the Federal courts"³⁷ under its Article III power to control federal court jurisdiction.³⁸ The distinction would not be relevant but for *Erie Railroad Co. v. Tompkins*,³⁹ in which the Court held that:

water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction. . . ." 9 U.S.C. § 1 (1988).

30. *Bernhardt v. Polygraphic Co. of Am., Inc.*, 350 U.S. 198, 201 (1955).

31. Jon R. Schumacher, *The Reach of the Federal Arbitration Act: Implications on State Procedural Law*, 70 N.D. L. REV. 459, 461 (1994).

32. *Allied-Bruce Terminix Co. v. Dobson*, 115 S. Ct. 834, 841-43 (1995).

33. 9 U.S.C. § 2 (1988).

34. H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924).

35. See U.S. CONST. art. I, § 8, cl. 3; *Hodel v. Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264, 276-77 (1981).

36. H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924).

37. *Prima Paint v. Flood & Conklin*, 388 U.S. 395, 405-06 n.13 (1966) (citing *Joint Hearings on S. 1005 and H.R. 646 before the Subcommittees of the Committees on the Judiciary*, 68th Cong., 1st Sess., 7 (1924)).

38. Article III of the United State Constitution states in part that "[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish." U.S. CONST. art. III, § 1.

39. 304 U.S. 64 (1938).

except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. . . . There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a State . . . and no clause in the Constitution purports to confer such power upon the federal courts.⁴⁰

After *Erie*, when a conflict arose in a diversity case between state and federal law, and that conflict would “significantly affect the result of a litigation,” the court had to apply state law.⁴¹ Therefore, if the FAA was considered a rule of procedure or a “substantive rule of common law”⁴² applicable to federal courts under Congress’ Article III powers, it would not apply to state courts. If, however, it was enacted to address “matters governed by the Federal Constitution or by Acts of Congress,”⁴³ as was the case with interstate commerce and the Commerce Clause, then the FAA would apply to state courts and federal courts equally. At the time the FAA was passed, Congress did not foresee the *Erie* decision and therefore did not specify which path it took in drafting the FAA. Through the years after *Erie*, the United States Supreme Court developed an interpretation of congressional intent.⁴⁴ In *Southland Corp. v. Keating*, the Court held that the FAA was enacted under Congress’ authority to regulate interstate commerce as provided in the Commerce Clause.⁴⁵ This interpretation was reaffirmed in *Allied-Bruce Terminix* but was questioned by the dissent.⁴⁶

C. “Evidencing a Transaction Involving Commerce”

While Congress’ conflicting statements caused confusion and disagreement regarding the scope of the FAA, congressional silence caused problems in determining when contracts

40. *Id.* at 78.

41. *Id.* at 80.

42. *Id.* at 77.

43. *Id.* at 78.

44. See *infra* part III.B-G.

45. *Southland Corp. v. Keating*, 465 U.S. 1 (1983); see *supra* note 10 and accompanying text.

46. *Allied-Bruce Terminix Co. v. Dobson*, 115 S. Ct. 834 (1995); see *infra* part IV.

evidenced a transaction involving commerce. As stated above, congressional intent was to create a statute that made "valid and enforceable [sic] agreements for arbitration contained in contracts involving interstate commerce."⁴⁷ Section 2 of the FAA specified that these contracts were to "evidenc[e] a transaction involving commerce."⁴⁸ However, Congress did not directly address the means by which courts could decide that contracts evidenced this transaction involving commerce. Without clear congressional direction, the courts were forced to develop and interpret a standard themselves. The unintended result of Congress' silence was a varied judicial interpretation of the Act's "evidencing a transaction involving commerce" requirement.

Before *Allied-Bruce Terminix*, the United States Supreme Court had never directly stated what standard it would apply to the issue.⁴⁹ Legal commentators were equally silent on the issue, often addressing preemption and applicability without mentioning the standard by which to determine whether a contract "evidences a transaction involving commerce."⁵⁰ However, lower federal courts and state courts did articulate standards for determining whether these transactions involved commerce for purposes of the FAA. These cases indicate two distinct tests created by the courts: the "contemplation of the parties" test and the "commerce-in-fact" test.

1. The "Contemplation of the Parties" Test

Some courts concluded that Congress did not intend for the FAA to extend to all transactions that Congress could constitutionally regulate. These courts generally followed the concurring opinion of Judge Lumbard in *Metro Industrial Painting Corp. v. Terminal Construction Co.*⁵¹

47. H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924).

48. 9 U.S.C. § 2 (1988).

49. See *infra* part III.A-B (discussing *Bernhardt* and *Prima Paint*).

50. See, e.g., Schumacher, *supra* note 31, at 463 ("the United States Supreme Court noted that the 'commerce' requirement is not difficult to fulfill.")

51. 287 F.2d 382 (1961).

[T]he legislative history of the Arbitration Act of 1925 reveals little awareness on the part of Congress that state law might be affected. . . . Congress was not seeking to regulate and control activity affecting commerce, but was providing for those engaged in interstate transactions an expeditious extra-judicial process for settling disputes. The Arbitration Act may be avoided entirely by those engaged in interstate traffic if they merely refrain from including any arbitration provisions in their contracts. . . . The significant question, therefore, is not whether, in carrying out the terms of the contract, the parties *did* cross state lines, but whether, at the time they entered into it and accepted the arbitration clause, they *contemplated* substantial interstate activity. . . . [E]vidence as to how the parties expected the contract to be performed and how it was performed is relevant to whether substantial interstate activity was contemplated.⁵²

The North Carolina Supreme Court in *Burke County Public Schools Board of Education v. Shaver Partnership*⁵³ was one of the courts to follow Judge Lumbard's reasoning in adopting the "contemplation of the parties" test.

The *Burke* case involved a multi-state architectural firm which entered a contract with the Burke County Public School Board to design two school buildings. The school board sued the firm when leaks were discovered in one of the buildings. The firm pointed out that the contract contained an arbitration agreement,⁵⁴ filed a demand for arbitration, and moved for a stay of litigation pending arbitration. Once the case reached the court of appeals, the dispositive issue was whether the contract evidenced a transaction involving commerce within the meaning of the FAA.⁵⁵ The court of appeals held that it did not evidence such a transaction, even though the contractual provi-

52. *Id.* at 386-87.

53. 279 S.E.2d 816 (1981).

54. The arbitration agreement provided that

all claims, disputes and other matters in question arising out of . . . this Agreement or the breach thereof shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then obtaining. This agreement so to arbitrate shall be specifically enforceable under the prevailing arbitration law.

Id. at 817.

55. *Id.*

sions indicated that the parties contemplated substantial interstate activity.⁵⁶ The North Carolina Supreme Court reversed, following the reasoning of Judge Lumbard in *Metro* that what was contemplated by the parties shall decide whether the contract evidences a transaction involving commerce.⁵⁷

The court held that the undisputed facts necessitated a finding that the parties contemplated substantial interstate activity and, therefore, evidenced a transaction involving commerce within the FAA.⁵⁸ The court, relying on Judge Lumbard's statement that "evidence as to how parties expected the contract to be performed and how it was performed is relevant to whether substantial interstate activity was contemplated,"⁵⁹ developed its own standard for applying section 2 of the FAA to contracts. It held that "[w]here . . . performance of the contract itself necessarily involves, so that the parties to the agreement must have contemplated, substantial interstate activity the contract evidences a transaction involving commerce within the meaning of the Federal Arbitration Act."⁶⁰ The facts applied to this standard established the interstate connection between the Indiana architectural firm and the North Carolina school board. From these facts the court concluded that "the parties in making the contract contemplated substantial interstate activity."⁶¹

56. *Id.* at 819.

57. *Id.* at 822-23.

58. The court stated that "there could be no doubt that the contract in question contemplated substantial interstate activity." *Burke*, 279 S.E.2d at 822. It listed the relevant evidence as:

The contract, a standard form agreement between owner and architect, states that it is between "Burke County (North Carolina) Public Schools Board of Education" and "Shaver & Company, a Partnership." Further, it specifically lists Lee J. Brockway as one of the principal architects and describes the project as being the construction of two high schools and other education facilities. Although the address of Shaver & Company is not given in the agreement between owner and architect, it is listed as follows on the standard form agreement between owner and contractor: "The Architect for this project is Shaver and Company, Lee J. Brockway, Architect, 105 Washington Street, Michigan City, Indiana." Further, the agreement between owner and contractor makes clear that the construction site of the high schools is Burke County.

Id. at 418-19.

59. *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 387 (1961).

60. *Burke*, 279 S.E.2d at 822.

61. *Id.* at 823.

The decision in *Burke* was followed in other courts as well. As recently as 1993, the United States District Court for the Eastern District of Virginia followed *Burke* and expressly adopted the reasoning of Judge Lumbard in *Metro*.⁶² The Supreme Court of Alabama also followed the *Burke* decision and adopted the "contemplation of the parties" test as the appropriate standard to determine if section 2 of the FAA applies to arbitration agreements.⁶³ This interpretation, however, created the dispute regarding section 2 applicability which invited the United States Supreme Court to review *Allied-Bruce Terminix*.

2. The "Commerce-in-Fact" Test

Although the "contemplation of the parties" test was enthusiastically adopted by a number of courts, the United States Court of Appeals for the Seventh Circuit in 1984 decided *Snyder v. Smith*⁶⁴ and established the "commerce-in-fact" test. This case was to become one of the most cited decisions employing this test.⁶⁵ The case involved a partnership among

62. *Lacheney v. Profitkey Int'l, Inc.*, 818 F. Supp. 922, 924 (1993). The court followed the North Carolina Supreme Court in *Burke*, adopting Judge Lumbard's reasoning.

63. *Warren v. Jim Skinner Ford, Inc.*, 548 So. 2d 157 (Ala. 1989). This case involved the purchase of a car. The sales agreement contained the following provisions:

1. That the motor vehicle described in this sale document has been heretofore traveling in interstate commerce and has an impact upon interstate commerce.

2. That in the event any dispute(s) under the terms of this contract of sale arise . . . the purchaser agree[s] to submit such dispute(s) to binding arbitration, pursuant to the provisions of 9 U.S.C. § 1, et seq. and according to the commercial rules of the American Arbitration Association then existing in Birmingham, Alabama.

Id. at 158. The court stated that "the appropriate standard for making [a determination that the FAA applies] is set forth in a special opinion in *Metro Industrial Painting Corp. v. Terminal Construction Co.*" *Id.* at 159. From the facts of the case, the court held that the parties did not contemplate substantial interstate activity in the retail sale of the car manufactured outside Alabama but sold in Alabama by an Alabama company to Alabama residents who were buying the car as consumers and not for commercial reasons. *Id.*

64. 736 F.2d 409 (7th Cir. 1984).

65. *Strickland*, *supra* note 3, at 417. Interestingly, this case was *not* cited in the United States Supreme Court's argument in adopting the "commerce-in-fact" test. *Allied-Bruce Terminix Co. v. Dobson*, 115 S. Ct. 834 (1995). Actually, the majority did not cite *any* cases to support its holding on this issue.

three Illinois residents to purchase property in Texas. The partnership agreement contained an arbitration provision signed by all three partners.⁶⁶ When one of the partners subsequently died, a dispute arose between the two remaining partners concerning the purchase price of the deceased's interest. Their dispute reached the United States Court of Appeals for the Seventh Circuit. In addressing the issue of applicability of the FAA, the court excluded a review of "maritime transactions" and narrowed the issue to "whether the partnership agreement evidence[d] a transaction involving commerce."⁶⁷ Considering prior Supreme Court decisions and the "strong federal policy favoring arbitration,"⁶⁸ the court decided that the FAA applies to all arbitration agreements which involve commerce; when deciding which contracts involve commerce, courts should take into account Congress' broad power to regulate under the Commerce Clause.⁶⁹

However, *Snyder* has been cited in a number of other decisions that follow its reasoning. In *Weatherly Cellaphonics Partners v. Hueber*, 726 F. Supp. 319 (D.D.C. 1989), the court cited *Snyder* to support the proposition that the "involving commerce" language of section 2 is "co-extensive with Congress' power under the commerce clause to reach activities affecting interstate commerce." *Id.* at 323. In *Mutual Reinsurance Bureau v. Great Plains Mutual Insurance Co.*, 750 F. Supp. 455 (D. Kan. 1990), the court cited *Snyder* to establish that "the strong policy favoring arbitration . . . [requires that] involving commerce . . . be construed broadly." *Id.* at 462 (citing *Snyder*, 736 F.2d at 417).

66. The arbitration agreement stated, in part, that

[a]ny controversy or claim arising out of or relating to this agreement, or to the interpretation, breach or enforcement thereof, shall be submitted to three arbitrators and settled by arbitration in the city of Houston, Texas, . . . provided, however, . . . if the matter submitted to arbitration shall involve a [dispute] as to the [purchase price] of a deceased, . . . Partner's Entire Partnership Interest, such arbitration shall be held before three arbitrators, one of whom shall be a certified public accountant and the other two of whom shall be licensed real estate appraisers maintaining offices and doing business in Harris County, Texas. . . . Any award made by any majority of the Arbitrators shall be final, binding, and conclusive on all parties hereto for all purposes, and a judgment may be enforced thereon in any court having jurisdiction thereof.

Snyder, 736 F.2d at 412-13.

67. *Id.* at 417.

68. *Id.* (citing *Societe Generale de Surveillance, S.A. v. Raytheon European Management and Sys. Co.*, 643 F.2d 863, 867 (1st Cir. 1981)).

69. *Id.* at 418. The court stated that "Congress intended the FAA to apply to all contracts that it constitutionally could regulate." *Id.*

The court assembled a line of United States Supreme Court and lower court cases to reach this conclusion. It started with the premise that “[s]ection 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements”⁷⁰ which requires that “any questions as to whether an issue is arbitrable are to be resolved in favor of arbitration.”⁷¹ Therefore, the appeals court reasoned, the requirement of “evidencing a transaction involving commerce” must be construed broadly.⁷²

The Seventh Circuit supported its “broad interpretation” reasoning with a number of United States Supreme Court decisions. It began with *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*,⁷³ in which the Supreme Court noted Congress’ intent to apply the FAA “not only [to] the actual physical interstate shipment of goods but also [to] contracts relating to interstate commerce.”⁷⁴ Next, the court referred to the holding in *Bernhardt v. Polygraphic Co.*,⁷⁵ where the Supreme Court held that the contract in dispute did not “involve commerce” because Bernhardt was not “working in commerce, producing goods in commerce, or engaging in activity that *affected* commerce.”⁷⁶ The Seventh Circuit also relied on the Supreme Court’s decision in *Southland Corp. v. Keating*⁷⁷ which “equated the breadth of ‘involving commerce’ with the extent of

70. *Id.* at 417, (citing *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

71. *Id.*

72. *Id.*

73. 388 U.S. 395 (1967).

74. *Id.* at 401-02, n.7, (quoting H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924)). The House Report stated in relevant part that:

[the FAA] declares that such agreements shall be recognized and enforced by the courts of the United States. The remedy is founded also upon the Federal control over interstate commerce and over admiralty. The control over interstate commerce reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce.

H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924).

75. 350 U.S. 198 (1956).

76. *Snyder v. Smith*, 736 F.2d 409, 417 (7th Cir. 1984) (emphasis added). The court borrowed this language from the *Bernhardt* decision where the Supreme Court stated that there was “no showing that petitioner while performing his duties under the employment contract was working ‘in’ commerce, was producing goods for commerce, or was engaging in activity that affected commerce, within the meaning of our decisions.” *Bernhardt*, 350 U.S. at 200-01.

77. 465 U.S. 1 (1983).

Congress's power to regulate under the commerce clause.⁷⁸ Finally, the court brought its reasoning full circle by stating that "[u]nder the commerce clause, Congress may reach activities 'affecting' interstate commerce."⁷⁹ Therefore, if the "involving commerce" language is as broad as Congress' Commerce Clause authority, and Congress may reach activities "affecting" interstate commerce under its Commerce Clause authority, then, the Seventh Circuit reasoned, it was logical to conclude that any contract "affecting" interstate commerce falls within section 2 of the FAA.⁸⁰

There are a number of cases that have reached similar conclusions without citing *Snyder* or expanding their reasoning beyond *Snyder*'s logical conclusion. In *Raytheon Co. v. Automated Business Systems*⁸¹ the United States Court of Appeals for the First Circuit applied the FAA to an arbitration agreement in a contract that "affected interstate commerce."⁸² In *Bridas Sociedad Anonima Petrolera Industrial Y Comercial v. International Standard Electric Corp.*,⁸³ the New York Court of Appeals stated that the FAA applies "where contractual activity facilitates, affects, or arises out of interstate or foreign commerce."⁸⁴ In *GAF Corp. v. Werner*,⁸⁵ the same court held that the FAA applied to an arbitration clause in an employment agreement "since the employment agreement affects interstate commerce."⁸⁶ These cases make it clear that the "commerce-in-fact" test is not burdensome to meet.

3. Difficulty with Two Different Tests

Under both the "contemplation of the parties" test and the "commerce-in-fact" test, courts apply the facts of the case to determine whether arbitration agreements are enforceable un-

78. *Snyder*, 736 U.S. at 418.

79. *Id.* (citing *Hodel v. Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264, 276-77 (1981)).

80. *Id.*

81. 882 F.2d 6 (1st Cir. 1989).

82. *Id.* at 9 (emphasis added).

83. 490 N.Y.S.2d 711 (1985).

84. *Id.* at 716 (emphasis added).

85. 484 N.Y.S.2d 12 (1985).

86. *Id.* at 15 (emphasis added).

der the FAA. Neither test offends the basic principle of the FAA to ensure enforcement of arbitration agreements. However, there is a difficulty in having two tests: when two different standards are applied to the same statute, parties may be subject to differing results under the same or similar factual situations. If the court employs the "commerce-in-fact" test, the proponent of FAA application will find it very simple to show that a contract evidenced a transaction involving commerce. Since "involving commerce" is "co-extensive" with Congress' authority under the Commerce Clause, almost all transactions in goods may be encompassed by section 2 of the FAA under the "commerce-in-fact" test.⁸⁷ However, if a court employs the "contemplation of the parties" test, it will be more difficult for the party proposing arbitration to show that the parties contemplated substantial interstate activity.

Congress' intent in enacting the FAA was to ensure the enforcement of arbitration agreements and decrease the burdens of litigation.⁸⁸ It would seem counterproductive to allow conflicting standards to exist. A given case could theoretically be decided differently depending on where the suit is brought. In addition, differing standards invite litigation to determine which standard is correct. This was the case in *Allied-Bruce Terminix*. However, before the *Allied-Bruce Terminix* decision can be meaningfully analyzed, a review of the prior United States Supreme Court cases interpreting and applying section 2 of the FAA must be conducted.

III. THE SUPREME COURT'S FAA § 2 ANALYSIS

Since the FAA was enacted, courts have attempted to interpret its applicability, the scope by which it was enacted, the breadth of its reach, and the preemptive powers of its various sections over state law. The Supreme Court has consistently taken opportunities to increase the importance of the FAA regarding these critical issues.⁸⁹ However, before it could reach a

87. See *Snyder v. Smith*, 736 F.2d 409, 418 (7th Cir. 1984).

88. See *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (1985); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967).

89. See *infra* part III.A-G.

decision regarding the scope of section 2 and the standard properly used to determine its applicability, the Court needed to establish the basic tenets of the FAA itself. In *Bernhardt v. Polygraphic Co. of America*⁹⁰ the Court found the opportunity to begin that process.

A. *Bernhardt v. Polygraphic Company of America*⁹¹

In *Bernhardt*, the Supreme Court began clarifying the scope of section 2 of the FAA. The case addressed a federal district court's denial of a motion for a stay of proceedings according to section 3 of the FAA⁹² despite the existence of a written arbitration agreement between the parties.⁹³ The case involved an employment contract made while Bernhardt was a New York resident. He later became a resident of Vermont and was to perform the duties of the contract in that state. The contract contained a provision stating that if a dispute arose, the parties would submit the dispute to arbitration under New York law by the American Arbitration Association. The Court further stated that any of the Association's determinations would be "final and absolute."⁹⁴ When a dispute did arise Bernhardt filed charges in Vermont state court for damages incurred from his discharge under the contract. The case was removed to the federal district court due to diversity of citizenship. Polygraphic then filed a motion to stay the proceedings so the controversy could be arbitrated, but the district court denied the motion.⁹⁵

90. 350 U.S. 198 (1955).

91. *Id.*

92. Section 3 provides:

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which the suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 3 (1988).

93. *Bernhardt*, 350 U.S. at 199-200.

94. *Id.* at 199.

95. *Id.*

The Supreme Court held that the denial of the motion was not in error because section 3, which requires a stay of litigation pending arbitration, does not apply unless the contract or transaction satisfies section 2.⁹⁶ Accordingly, the Court reviewed the requirements of section 2 and found that no maritime action was involved and that the contract did not evidence “a transaction involving commerce.”⁹⁷

An important note to the decision is Justice Douglas’ implication that the FAA’s “evidencing a transaction involving commerce” requirement can be satisfied by showing that the petitioner “was working ‘in’ commerce, was producing goods for commerce, or was engaging in activity that affected commerce.”⁹⁸ This implication has been used by the current Court to support the contention that the FAA should be construed broadly.⁹⁹

Although *Bernhardt* shed light on the scope of section 2, it did not address the authority upon which it was enacted. The Court did not directly address “whether arbitration touched on substantive rights . . . or was a mere form of procedure within the power of the federal courts or Congress to prescribe.”¹⁰⁰ Justice Thomas, dissenting in *Allied-Bruce Terminix*, posits that *Bernhardt* shows that, for *Erie* purposes, the question of whether a court could stay litigation brought in breach of an arbitration agreement is one of substantive law.¹⁰¹ The *Bernhardt*

96. *Id.* at 202 (“We conclude that the stay provided in § 3 reaches only those contracts covered by §§ 1 and 2.”)

97. *Id.* at 200.

98. *Id.* at 201.

99. Justice Berger relied upon this language in *Allied-Bruce Terminix* where he held that the FAA should be interpreted broadly to extend the Act’s reach to the limits of Congress’ Commerce Clause powers. 115 S. Ct at 837-43. Justice Breyer equated “involving” commerce with “affecting” commerce. *Id.* at 840-41. When Congress uses the word “affecting,” it usually intends that the statute employ the full limits of congressional power. See Civil Rights Act of 1964, 42 U.S.C. § 2000a(b) (1988); National Labor Relations Act, 29 U.S.C. § 160(a) (1988).

100. *Bernhardt*, 350 U.S. at 202. The critical issue is whether the FAA is based upon the commerce power of the U.S. CONST, art. I, § 8, cl. 3, or the power of Congress to prescribe procedural rules for Federal Courts under art. III, § 1. Since the Court did not decide, it remained a matter of statutory interpretation, legislative interpretation, and conjecture.

101. *Allied-Bruce Terminix Co.*, 115 S. Ct. at 848 (Thomas J., dissenting); see also *Bernhardt*, 350 U.S. at 203-04 (stating that “[t]he change from a court of law to an arbitration panel may make a radical difference in ultimate result.”).

Court avoided the issue by reading section 3 of the FAA narrowly, holding that section 3 does not apply on its own.¹⁰²

B. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*¹⁰³

The silence regarding congressional authority upon which the FAA rested was broken in *Prima Paint*. This case involved Prima Paint's claim of "fraud in the inducement" against Flood & Conklin. Prima Paint contracted to purchase Flood & Conklin's paint business. The contract contained a broad arbitration clause.¹⁰⁴ A dispute arose between the parties and Prima Paint notified Flood & Conklin that they had violated the agreement.¹⁰⁵ Flood & Conklin then served notice of intention to arbitrate and Prima Paint filed a federal diversity suit to rescind the agreement. The district court granted Flood & Conklin's motion to stay the action pending arbitration, and the court of appeals dismissed Prima Paint's appeal of that decision.¹⁰⁶

This case presented a problem that had not yet been addressed in previous FAA cases.¹⁰⁷ In *Erie Railroad Co. v.*

102. *Bernhardt*, 350 U.S. at 202; see *supra* note 92 for the language of section 3.

103. 388 U.S. 395 (1967).

104. *Id.* at 398. The clause read in part: "Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association. . . ." *Id.*

105. Prima Paint proceeded upon the theory that since there was "fraud" in the inducement to enter into the contract, the entire contract should be rescinded. *Id.* at 399. This, they argued, would comport with the FAA in that section 2 states that an arbitration agreement is "valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*" *Id.* at 400 (quoting 9 U.S.C. § 2 (1988)) (emphasis added). The Court held that since the claim of fraud relates to the contract as a whole, and not to the arbitration agreement itself, the denial of Prima Paint's appeal should be affirmed. *Id.* at 406. Therefore, since there was no evidence that Flood & Conklin fraudulently induced Prima Paint to enter into the agreement to arbitrate any controversy arising under the contract, the Court of Appeals decision was affirmed. *Id.* at 407.

106. 360 F.2d 315 (2d Cir. 1966).

107. Due to the holdings of *Erie* and *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945), "federal courts are bound in diversity cases to follow state rules of decision in matters which are 'substantive' rather than 'procedural,' or where the matter is 'outcome determinative.'" *Prima Paint*, 388 U.S. at 404-05. *Bernhardt* avoided this issue by not deciding "whether section 2 creates a federal right or whether the [holding] extends to diversity cases involving section 2 contracts." Note, *Erie, Bernhardt, and*

*Tompkins*¹⁰⁸ the Supreme Court held that a federal court sitting in diversity must apply the substantive law of the state in which it sits.¹⁰⁹ This posed a problem for the Court in *Prima Paint*. To apply the FAA, the Court would have to determine whether it was substantive law or procedural law. If procedural, the FAA would not be applicable due to the holding in *Erie*. If substantive, the Court could apply the FAA to this case but would have to substantiate its decision with a definitive statement listing supporting evidence. Such a definitive statement had not been made by the Court in any prior decision.

In the Court's discussion regarding the applicability of the FAA, Justice Fortas boldly stated that "it is clear beyond dispute that the federal arbitration statute is based upon and confined to the incontestable federal foundations of 'control over interstate commerce and over admiralty.'"¹¹⁰ Thus, the potential *Erie* problem was solved by changing the focus from rules of procedure to commerce clause authority, thereby avoiding the problem of federal substantive rules governing diversity cases.¹¹¹

Discussing the "involving commerce" requirement of section 2, Justice Fortas again boldly stated that "[t]here could not be a clearer case of a contract evidencing a transaction in interstate commerce."¹¹² However, in making this decree, he failed to define the standard by which he concluded the contract evidenced a transaction "involving commerce."¹¹³ Therefore, the Court

Section 2 of the United States Arbitration Act: A Farrago of Rights, Remedies, and a Right to a Remedy, 69 YALE L.J. 847, 849 (1960).

108. 304 U.S. 64 (1938).

109. *Id.*

110. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 405 (1967) (citing H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924); S. REP. NO. 536, 68th Cong., 1st Sess., 3 (1924)). *But see id.* at 418-19 (Black, J., dissenting) ("One cannot read the legislative history without concluding that [Congress' power to prescribe the jurisdiction and duties of the Federal Courts], and not Congress' power to legislate in the area of commerce, was the 'principal basis' of the Act.")

111. The *Prima Paint* Court stated that instead of addressing the issue of "whether Congress may fashion federal substantive rules to govern questions arising in simple diversity cases," the Court was now addressing "whether Congress may prescribe how federal courts are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate." *Id.* at 405.

112. *Id.* at 401.

113. Instead of stating a general rule to define this requirement, Justice Fortas offered very fact specific evidence of the agreement entered into by the parties. *See*

applied little more than a factual summary of the agreement in question to satisfy the requirement,¹¹⁴ leaving future courts to decide the appropriate standard to apply.

One possibility for the lapse was simply that the Court chose not to address the issue (or did not see a need to address the issue) of a standard of FAA applicability to contracts. Another possibility is that Justice Fortas was indirectly confirming a "commerce-in-fact" test.¹¹⁵ By stating that the mere existence of goods involving interstate commerce—without mentioning any other requirement for application of the FAA—was sufficient to warrant application of the FAA, it can be speculated that this liberal "commerce-in-fact" standard is the appropriate standard. However, the Court did not take a position on the issue.

C. Moses H. Cone Memorial Hospital v. Mercury Constr. Co.¹¹⁶

Although *Prima Paint* established that the FAA was substantive law to be applied in federal court, the Court did not address the issue of whether the FAA should be applied in a state court proceeding. Given the Court's admission that the FAA was enacted under the "federal foundations of 'control over interstate commerce,'"¹¹⁷ the Court had to decide whether contracts disputed in state courts were beyond the reach of the FAA. In *Moses H. Cone*, the Court addressed this issue and found that the FAA would apply to state court proceedings.¹¹⁸

Moses H. Cone Memorial was a hospital located in North Carolina that entered into a contract for the construction of additions to its facilities.¹¹⁹ The company they chose to complete the work was Mercury Construction, a firm based in Alabama.¹²⁰ The contract between the hospital and Mercury con-

id. at 401, n.6.

114. *Id.*

115. See *supra* part II.C.2.

116. 460 U.S. 1 (1983).

117. *Prima Paint*, 388 U.S. at 405.

118. *Moses H. Cone*, 460 U.S. at 27.

119. *Id.* at 4.

120. *Id.*

tained provisions for dispute resolution.¹²¹ It stated that all disputes involving interpretation of the contract or performance of the contract should be referred to the architectural firm hired by the hospital to oversee the project.¹²² The contract further stated that any dispute decided by the architectural firm, or not decided by it within a stated period of time, could be submitted by either party to binding arbitration.¹²³

Mercury claimed it suffered delay and impact costs as a result of hospital delay and inaction. Although Mercury tried to get the hospital to pay these costs, the hospital refused to pay and sued.¹²⁴ The hospital filed its suit in state court to obtain a stay of arbitration.¹²⁵ Mercury filed suit in federal court seeking an order compelling arbitration under section 4 of the FAA.¹²⁶ The hospital then made a motion in district court to stay the federal court suit because identical issues were being argued and the district court granted the stay.¹²⁷ Mercury sought review in the Court of Appeals for the Fourth Circuit, and the court reversed the stay and remanded the case back to district court with instructions for entry of an order to arbitrate.¹²⁸ The hospital appealed that decision to the United States Supreme Court.¹²⁹

In relevant part, Justice Brennan, writing for the majority, held that the district court's stay "frustrated the statutory policy of rapid and unobstructed enforcement of arbitration agree-

121. *Id.*

122. *Id.*

123. *Id.* at 5. The arbitration clause contained in the contract read:

All claims, disputes and other matters in question arising out of, or relating to, this Contract or the breach thereof, . . . shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then obtaining unless the parties mutually agree otherwise. This agreement to arbitrate shall be specifically enforceable under the prevailing arbitration law. The award rendered by the arbitrators shall be final, and judgment may be entered upon it in accordance with applicable law in any court having jurisdiction thereof.

Id.

124. *Id.* at 7.

125. *Id.*

126. 9 U.S.C. § 4 (1988).

127. *Moses H. Cone*, 460 U.S. at 7.

128. *Id.* at 8.

129. *Id.*

ments.”¹³⁰ The Court reiterated the holding in *Prima Paint* that the FAA was a body of federal substantive law applicable to arbitration agreements covered by the Act.¹³¹ In addressing the question of arbitrability and section 2, the Court held that there exists “a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary,” and that the issues here were arbitrable.¹³²

This language in the holding, affirming *Prima Paint*’s broad interpretation of the FAA, offered nothing dramatically different. However, Justice Brennan proceeded in the opinion to take steps towards a radical interpretation of the FAA. In dicta, he interpreted the FAA’s ambiguous language in section 3, referring to the FAA’s application in “any of the courts of the United States.”¹³³ He held that “state courts, as much as federal courts, are obliged to grant stays of litigation under § 3 of the Arbitration Act.”¹³⁴ This, he added, was in accordance with the practices of the state courts themselves, who “have almost unanimously recognized that the stay provision of § 3 applies to suits in state as well as federal courts.”¹³⁵ For the first time, the Court held that sections of the FAA were to be applied in state court as well as federal court. The necessity for this finding, as stated by the Court, was to “carry out Congress’ intent to mandate enforcement of all covered arbitration agreements; Congress can hardly have meant that an agreement to arbitrate can be enforced against a party who attempts to litigate an arbitrable dispute in federal court, but not against one who sues on the same dispute in state court.”¹³⁶

130. *Id.* at 23.

131. *Id.* at 24 (citing *Prima Paint*, 388 U.S. 395 (1967)).

132. *Id.*

133. *Id.* at 26, n.34.

134. *Id.* at 26.

135. *Id.* at 26, n.34. Interestingly, the case chosen for support of this point was *Burke County Pub. Sch. Bd. of Education v. Shaver Partnership*, 279 S.E.2d 816 (1981). As discussed above, see part II.C.1., *Burke* has been relied upon in other courts to support the argument that the appropriate test for determining the applicability of the FAA is the “contemplation of the parties” test. It is unlikely that Justice Brennan could have foreseen the controversy surrounding the holding of that case.

136. *Moses H. Cone*, 460 U.S. at 26, n.34.

Section 2 was not directly addressed, but by applying the holding in *Bernhardt* that section 3 of the FAA was not applicable until section 2 is satisfied, section 2 should have been found applicable in state court proceedings as well. However, the Court was silent as to the appropriate standard by which applicability should be decided. Despite the fact that the Court's opinion about the FAA's applicability was placed in dicta, the foundation was set for a decision to expressly hold that sections of the FAA apply in state and federal court. It would take only eleven months for the Court to seize upon this opportunity in *Southland Corp. v. Keating*.¹³⁷

D. *Southland Corp. v. Keating*¹³⁸

In *Southland*, the Court reaffirmed its prior holdings¹³⁹ and stated that section 2 is a substantive statute derived from the Commerce Clause.¹⁴⁰ In this case, several franchisees, including Mr. Keating, brought suit against the franchisor, Southland Corporation, for violating several laws in addition to a violation of the California Franchise Investment Law.¹⁴¹ The contracts the franchisees had signed contained an arbitration agreement.¹⁴² Southland moved to compel arbitration of the claims pursuant to the arbitration agreement and the FAA.¹⁴³ The California Supreme Court refused to compel arbitration because it interpreted the state investment law to provide for judicial consideration of claims brought under it.¹⁴⁴

Once establishing that the FAA was enacted under Commerce Clause authority,¹⁴⁵ the Supreme Court proceeded to determine that the clause's broad power afforded Congress the

137. 465 U.S. 1 (1983).

138. *Id.*

139. See *Moses H. Cone Memorial Hospital v. Mercury Const. Co.*, 460 U.S. 1 (1982); *Prima Paint*, 388 U.S. 395 (1967).

140. *Southland*, 465 U.S. at 11.

141. *Id.* at 4.

142. *Id.* The Arbitration Agreement read in part: "Any controversy or claim arising out of or relating to this Agreement or the breach thereof shall be settled by arbitration . . . and judgment upon any award rendered by the arbitrator may be entered in any court having jurisdiction thereof." *Id.*

143. *Id.*

144. *Id.* at 5.

145. *Id.* at 11.

ability to broaden the application of substantive rules to govern commerce.¹⁴⁶ Chief Justice Burger left his mark upon the FAA by writing for a Supreme Court which held for the first time that the broad Commerce Clause power requires that section 2 of the FAA be applied to state courts as well as federal courts.¹⁴⁷ Relying on the Court's prior decision in *Prima Paint*, he reasoned that when Congress exercises Commerce Clause authority to enact substantive federal law, "it normally creates rules that are enforceable in state as well as federal courts."¹⁴⁸ And in so doing, "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements."¹⁴⁹ Thus, the state law in question was found to violate the Supremacy Clause¹⁵⁰ because of its direct conflict with section 2 of the FAA, and was preempted.¹⁵¹

The Court did not address the FAA's "evidencing a transaction involving commerce" requirement.¹⁵² However, Chief Justice Burger incorporated the "involving commerce" language into his rationale that the FAA is applicable to state courts. He reasoned that if Congress' intention was to apply the FAA to state courts, it would need to proceed under the Commerce Clause.¹⁵³ Therefore, the "involving commerce" language was "a necessary qualification on a statute intended to apply in

146. *Id.* at 12.

147. *Id.* at 12-16. Justice Thomas pointed out in *Allied-Bruce Terminix Co. v. Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 407 (2d Cir. 1959), was the first time a federal court held that § 2 applied to state courts. 115 S. Ct. at 845 (Thomas, J., dissenting). The Supreme Court first presented the idea that the FAA was applicable to state courts in *Moses H. Cone Hospital v. Mercury Const. Co.*, 460 U.S. 1 (1983). However, this language was dicta in that it was not necessary for the decision of the case. *Id.* at 25-26.

148. *Southland*, 465 U.S. at 12 (citing *Prima Paint*, 388 U.S. at 420).

149. *Id.* at 16.

150. The Supremacy Clause provides that the "Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby. . . ." U.S. CONST. art. VI, § 2. In this case, it was proposed that the FAA was enacted pursuant to the Constitution through the Commerce Clause.

151. *Southland*, 465 U.S. at 16.

152. 9 U.S.C. § 2 (1988).

153. *Southland*, 465 U.S. at 14. For Congress to prescribe law applicable to state courts, it must proceed under the Commerce Clause of the Constitution. *See supra* part II.B.

state and federal courts.”¹⁵⁴ It was not “an inexplicable limitation on the power of the federal courts,” as those who questioned the determination that the FAA is based on the commerce powers of Congress argued.¹⁵⁵

Southland was met with skepticism by its dissenting Justices¹⁵⁶ and commentators alike.¹⁵⁷ Whether the Court would take the opportunity to reverse or clarify the *Southland* holding was soon answered with *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*¹⁵⁸ in 1985.

E. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*¹⁵⁹

The *Mitsubishi* case involved a suit filed by Mitsubishi against Soler Chrysler-Plymouth for a number of alleged damages and breaches of a sales agreement.¹⁶⁰ Mitsubishi and Soler entered into a dealership agreement and sales agreement providing for sales of Mitsubishi vehicles in certain designated areas.¹⁶¹ The sales agreement contained an arbitration clause providing that all disputes arising out of certain articles of the agreement, or breach thereof, would be arbitrated by the Japan Commercial Arbitration Association.¹⁶² Although first year

154. *Id.* at 14-15.

155. *Id.* at 14. It is likely that Chief Justice Burger was referring to Justice O'Connor's dissenting opinion in which she characterized the decision as “inexplicable.” *Id.* at 36.

156. *Id.* at 17 (Stevens, J., concurring in part and dissenting in part); *Id.* at 21 (O'Connor, J., dissenting, joined by Rehnquist, C.J.).

157. See Carlos R. Carrasquillo, *Commercial Arbitration: Southland Corp. V. Keating—Section 2 of the Federal Arbitration Act Preempts State Law in the Field of Commercial Arbitration*, 10 J. CORP. L. 767 (1985). Carrasquillo agrees with the determination that the FAA applies in state and federal court but hesitates to endorse the decision wholeheartedly. He suggests that the FAA should not entirely displace state law providing “other remedies to vindicate section 2 rights. Thus, any procedural remedies for enforcing section 2 rights in state courts should be provided for by the state, to the extent that such procedures do not directly conflict with the purposes of the FAA.” *Id.* at 784; see also Hirshman, *supra* note 15, at 1345 (noting that the majority's opinion is not “without flaws,” in that it “produces anomalous results.”)

158. 473 U.S. 614 (1985).

159. *Id.*

160. *Id.* at 618, n.2.

161. *Id.* at 617.

162. The arbitration agreement provided, in part, that:

sales were brisk, the car market evaporated and Soler requested that certain agreement modifications be allowed.¹⁶³ Mitsubishi refused and withheld further shipment of new vehicles.¹⁶⁴ Mitsubishi then demanded that the dispute be arbitrated under the terms of the agreement and pursuant to section 4 of the FAA.¹⁶⁵ When the parties failed to work things out, a complex network of motions, complaints, and counter-complaints ensued.¹⁶⁶ The federal district court, in which these motions were filed, held that the disputes were subject to arbitration.¹⁶⁷ Of particular concern to the parties was the arbitrability of statutory antitrust claims when the agreement from which the claims arose was drafted for an international transaction.¹⁶⁸ The district court held that they were arbitrable, and the United States Court of Appeals for the First Circuit affirmed this part of the decision.¹⁶⁹ Upon review by the United States Supreme Court, the Court affirmed that part of the appeals court's holding.¹⁷⁰

The Court held that in this case the statutory claim was arbitrable under the FAA.¹⁷¹ The Court set forth a two part test for answering this question. The Court reasoned that it must be determined whether the parties agreed to arbitrate.¹⁷² If they did then the parties should be held to this agreement and the parties must look to the specific statute under which the dispute arose to determine whether there is a congressional intent to "preclude a waiver of judicial remedies for the statutory rights at issue."¹⁷³ In support of this test the Court cited

[a]ll disputes, controversies or differences which may arise between [Mitsubishi] and [Soler] out of or in relation to Articles I-B through V of this Agreement or for the breach thereof, shall be finally settled by arbitration in Japan in accordance with the rules and regulations of the Japan Commercial Arbitration Association.

Id.

163. *Id.*

164. *Id.* at 618.

165. *Id.*

166. *Id.* at 619-20.

167. *Id.* at 620-21.

168. *Id.* at 621.

169. 723 F.2d 155 (1st Cir. 1983).

170. *Mitsubishi*, 473 U.S. at 629.

171. *Id.*

172. *Id.* at 627.

173. *Id.* at 628.

Southland and *Moses H. Cone* for the proposition that arbitration agreements "must be addressed with a healthy regard for the federal policy favoring arbitration,"¹⁷⁴ and that courts must rely on the congressional intent expressed in the statute in order to determine if there are categories of claims that are not enforceable by arbitration.¹⁷⁵

The importance of the *Mitsubishi* decision to section 2 of the FAA is indirect. The Court did not address whether the contract "involved interstate commerce" because the subject at issue was arbitration of statutory rights rather than a contract clause "evidencing a transaction involving interstate commerce."¹⁷⁶ The relevance of *Mitsubishi* is the continuance of a broad interpretation of the applicability of the FAA to a wide array of arbitration agreements. The Court had taken new steps in broadening the applicability of the FAA in *Southland* and this affirmation strengthened the decision and the idea that the FAA was intended to be an expansive statute to be applied liberally to contracts containing arbitration agreements.

Therefore, the Court in *Mitsubishi* supported the decision in *Southland* and continued to expansively interpret the applicability of the FAA. However, because *Mitsubishi* was in federal court, the Court did not have to expressly affirm *Southland*'s holding that the FAA applied in state court as well as federal court.¹⁷⁷ Such a case was soon before the Supreme Court and it would force the Court to decide whether the *Southland* decision was correct or whether it could be abandoned or modified to the point of reversal.

174. *Moses H. Cone*, 460 U.S. 1, 24 (1982).

175. *Southland*, 465 U.S. 1, 16 n.11 (1983).

176. Justice Stevens addressed this point in his dissent and found it to be dispositive, contrary to the majority's opinion that it was not. He stated:

[u]ntil today all of our cases enforcing agreements to arbitrate under the Arbitration Act have involved contract claims. . . . But this is the first time the Court has considered the question whether a standard arbitration clause referring to the claims arising out of or relating to a contract should be construed to cover statutory claims that have only an indirect relationship to the contract. In my opinion, neither the Congress that enacted the Arbitration Act in 1925, nor the many parties who have agreed to such standard clauses, could have anticipated the Court's answer to that question.

Mitsubishi, 473 U.S. at 646-47.

177. *Southland*, 465 U.S. at 10.

F. Perry v. Thomas¹⁷⁸

The case presented to the Supreme Court originated when Kenneth Thomas brought suit against his former employer and two of its employees, one of whom was Barclay Perry.¹⁷⁹ Thomas sold securities for Kidder, Peabody & Co.¹⁸⁰ While working for them, Thomas became upset about his commissions for the sale of securities.¹⁸¹ Thomas alleged various breaches by Perry and others in the company.¹⁸² Perry and the other employee filed a petition to compel arbitration pursuant to a provision in an employment registration form that was signed by Thomas.¹⁸³ Thomas argued that California law authorized maintaining wage collection actions despite such an agreement.¹⁸⁴

In addressing the California Court of Appeals' affirmation of the lower court's refusal to compel arbitration, Justice Marshall stated that section 2 of the FAA preempts the California statute.¹⁸⁵ He reiterated that section 2 is substantive law enacted pursuant to the Commerce Clause and is enforceable in both state and federal courts.¹⁸⁶ He therefore reinforced the holding in *Southland* that section 2 preempts state statutes to the contrary.¹⁸⁷

178. 482 U.S. 483 (1987).

179. *Id.* at 484.

180. *Id.*

181. *Id.*

182. *Id.* at 484-85. These breaches included "breach of contract, conversion, civil conspiracy to commit conversion, and breach of fiduciary duty." *Id.*

183. *Id.* at 485. The form was a Uniform Application for Securities Industry Registration form and contained the following provision, in part: "I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions or by-laws of the organizations with which I register. . . ." *Id.*

184. *Id.* at 486. The statute provided that actions for the collection of wages may be maintained "without regard to the existence of any private agreement to arbitrate." CAL. LAB. CODE ANN. § 229 (West 1989).

185. *Perry*, 482 U.S. at 490-91.

186. *Id.* at 489.

187. *Id.* at 491. An interesting element of this case is the dissenting opinion of Justice Stevens. *Id.* at 493 (Stevens, J., dissenting). He stated that Congress did not intend the FAA to preempt state law and that the courts had "rewritten" the Act to give it this effect. *Id.* In *Southland*, however, Justice Stevens concurred with the majority and stated that he agreed with the conclusion that "an arbitration

Instead of abandoning the holding in *Southland*, the Court strengthened it by affirming the principles stated by Chief Justice Burger in that decision.¹⁸⁸ *Perry* secured the *Southland* decision and thereby introduced the doctrine of stare decisis that was later applied to *Southland*, and questioned by both Justice O'Connor and Justice Thomas in *Allied-Bruce Terminix*.¹⁸⁹ *Perry* did not discuss the FAA's "evidencing a transaction involving commerce" requirement since it was not at issue. Justice Marshall did, however, broaden the scope of the FAA to encompass the "full reach of the Commerce Clause."¹⁹⁰

G. Volt Information Sciences Inc. v. Board of Trustees of Leland Stanford Junior University¹⁹¹

From the history of Supreme Court decisions interpreting the breadth of the FAA, there seemed to be no practical limitations, aside from the exclusions set forth in section 2 itself.¹⁹² However, in *Volt* the Court clarified the focus of the FAA in disputes involving the application of arbitration procedures that are specifically set out in an arbitration agreement. The Court had to weigh the liberal enforcement policy regarding arbitration agreements and the preemption of conflicting state law against the undecided issue of whether the FAA dictates one arbitration procedure over another.¹⁹³

clause . . . is equally enforceable if the action is brought in a state court" despite Justice O'Connor's review of legislative history that indicated Congress enacted the Act "as essentially procedural in nature. . . ." *Southland*, 465 U.S. at 17. He justified his concurrence by reasoning that the "intervening developments in the law compel the conclusion that the Court reached." *Id.* The difference that is drawn between the two statements is that Justice Stevens, as does Justice O'Connor, believes that the states should be given power to except certain categories of disputes from arbitration. *Perry*, 482 U.S. at 494.

188. *Perry*, 482 U.S. at 489-90.

189. *Allied Bruce Terminix Companies, Inc. v. Dobson*, 115 S. Ct. 834, 843 (O'Connor, J., concurring); *id.* at 849 (Thomas, J., dissenting).

190. *Perry*, 482 U.S. at 490.

191. 489 U.S. 468 (1989).

192. Section 2 of the FAA excludes enforcement of arbitration agreements that would otherwise be unenforceable "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (1988).

193. This issue was addressed in *Moses H. Cone*, 460 U.S. at 26 n.34. The Court stated that section 3, although not expressly stated in the FAA, applied to state courts since almost a majority of the state courts followed section 3 procedures. *See*

Volt Information Sciences entered into a contract with the Board of Trustees of Leland Stanford Junior University for construction of the university's electrical system.¹⁹⁴ The contract contained an arbitration agreement covering all disputes "arising out of or relating to this contract or breach thereof."¹⁹⁵ The contract also contained a choice of law clause which provided that the contract was to be governed by the place where the project was located.¹⁹⁶

During performance of the contract, a dispute arose and Volt demanded arbitration.¹⁹⁷ In response, the university filed suit in state court, alleging fraud and breach of contract.¹⁹⁸ Volt petitioned the court to compel arbitration under section 4 of the FAA and to stay arbitration. The court denied Volt's petition to compel arbitration and the California Court of Appeals affirmed the decision, holding that the choice of law provision required the contract be governed by California arbitration law.¹⁹⁹ This statute permitted courts to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it if there was a possibility of conflicting rulings on a common issue of law or fact.²⁰⁰ The court followed the statute and affirmed the lower court's decision to stay arbitration because such a situation existed here.²⁰¹ Volt submitted a petition for discretionary review with the California Supreme Court which was denied.²⁰² The Unit-

supra notes 33-36 and accompanying text.

194. *Volt*, 489 U.S. at 470.

195. The arbitration clause, as listed in the case, reads as follows:

All claims, disputes and other matters in question between the parties to this contract, arising out of or relating to this contract or breach thereof, shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then prevailing unless the parties mutually agreed [sic] otherwise. . . . This agreement to arbitrate . . . shall be specifically enforceable under the prevailing arbitration law.

Id. at 470 n.1.

196. *Id.* at 470.

197. *Id.*

198. *Id.*

199. *Id.* at 471.

200. CAL. CIV. PROC. CODE ANN. § 1281.2(c) (West 1982).

201. *Volt*, 489 U.S. at 472.

202. *Id.* at 473.

ed States Supreme Court held that it had appellate jurisdiction and affirmed the decision.²⁰³

The Supreme Court, through the opinion of Chief Justice Rehnquist, reiterated the holding in *Moses H. Cone*²⁰⁴ and *Mitsubishi*²⁰⁵ that when “applying general state-law principles of contract interpretation to the interpretation of an arbitration agreement within the scope of the Act . . . due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration.”²⁰⁶ However, the Court narrowed the reach of the FAA in arbitration applicability in holding that the FAA’s purpose is to “ensure the enforceability, according to the terms, of private agreements to arbitrate” and does not dictate the “set of procedural rules” to be employed in arbitration.²⁰⁷ Therefore, the Court found that the FAA did not preempt California state law governing arbitration. The Court went on to confirm that the FAA is a preemptive federal law that should govern over *conflicting* state law “to the extent that it ‘stands as an obstacle to the accomplishment and execution of the full purpose and objectives of Congress’”²⁰⁸

The Court explained that the FAA, as a preemptive law, was to apply in state courts as well as federal courts.²⁰⁹ It cited *Southland* to support its statement that sections 1 and 2 of the FAA are substantive provisions applicable to both state and federal courts.²¹⁰ However, the Court clarified the misconception in the *Moses H. Cone* footnote²¹¹ which postulated that section 3 also applies to state court, if not expressly, then indirectly, through the practices of almost all the state courts. The Court stated that neither section 3 nor 4 have ever been held to be applicable to state court.²¹²

203. *Id.*

204. 460 U.S. 1 (1982).

205. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985).

206. *Volt*, 489 U.S. at 475-76.

207. *Id.*

208. *Id.* at 477 (citing *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

209. *Id.*

210. *Southland*, 465 U.S. 1, 12 (1983).

211. 460 U.S. at 26 n.32 (1982); see *supra* notes 33-36 and accompanying text.

212. *Volt*, 489 U.S. at 477 n.6 (stating “we have never held that §§ 3 and 4 . . . are nonetheless applicable in state court”). The current Court, in *Allied-Bruce*

H. *Status of Section 2 of the FAA after Volt*

After *Volt*, what remained of section 2 of the FAA was an act interpreted to be substantive law, authorized by the Commerce Clause powers delegated to Congress, applied in state and federal court, which preempted contradictory state law. The precedents established a willingness on the part of the Supreme Court to broadly interpret the FAA's section 2 language. However, much was left to be determined regarding section 2 of the FAA that had not yet been addressed or had been left unclear by the Court in prior decisions.

Perhaps the most basic issue never directly addressed by the Court was the standard by which the FAA, and section 2, was applicable to arbitration agreements. By its very language, section 2 does not require that all arbitration agreements be enforced. Specifically, the agreements covered are those which are written and contained in (1) "maritime transactions," (2) "contracts evidencing a transaction involving commerce," or (3) agreements in writing submitting existing controversies arising out of such contracts to arbitration.²¹³ Since the third agreement is easily identified by the fact that it involves an "existing controversy," and the first agreement by definition is easily defined by referring to a "maritime transaction," the Court only had to determine what was meant by "evidencing a transaction involving commerce." As discussed above, the Court had not directly addressed this issue previously and the lower courts had interpreted this language in two different ways.²¹⁴ Therefore, the next step in interpreting the scope and applicability of section 2 of the FAA was to offer a definitive standard by which this determination could be made. The Court addressed this issue, and revisited previously discussed issues, in *Allied-Bruce Terminix v. Dobson*.²¹⁵

Terminix, did not address sections 3 and 4 and the issue of preemption. The Court has not addressed whether these sections should be applied in state courts. Despite their plain language references to "federal courts," the current Court thought it unwise to preclude their application in state courts.

213. 9 U.S.C. § 2 (1988).

214. See *supra* part II.C.

215. 115 S. Ct. 834 (1995).

IV. THE SUPREME COURT'S ANALYSIS OF *ALLIED-BRUCE TERMINIX*

By 1993, courts were interpreting the FAA broadly but were applying differing standards to determine the applicability of section 2 of the FAA. The Supreme Court of Alabama had adopted the "contemplation of the parties" test and applied it to a dispute involving a pest control company and an Alabama homeowner.²¹⁶ The case was appealed and allowed the United States Supreme Court to directly address the issues of scope, standards, and applicability that had been ambiguous or disputed in past cases.

A. *Facts and Procedural History*

Allied-Bruce Terminix began when a controversy arose between the parties over a contract to inspect for and guard against termites.²¹⁷ The contract contained guarantees and promises that Allied-Bruce Terminix would protect the house and honor the terms of the plan.²¹⁸ The plan also contained an agreement to settle all claims or controversies "exclusively by arbitration."²¹⁹ After closing on the purchase of their house, at which time the contract was transferred, the Dobsons discovered extensive termite infestation.²²⁰

The Dobsons sued the previous owners, Terminix, and Terminix International, alleging fraud.²²¹ Terminix and Terminix International moved to stay the proceedings and com-

216. *Allied-Bruce Terminix Co. v. Dobson*, 628 So. 2d 354 (Ala. 1993).

217. *Allied-Bruce Terminix Co. v. Dobson*, 115 S. Ct. 834 (1995). The Gwins purchased a lifetime "Termite Protection Plan" ("Plan") for their house in Alabama from Allied-Bruce Terminix in August, 1987. The plan was guaranteed by Terminix International which has its principle place of business in Tennessee. *Id.* Terminix is a franchise of Terminix International and is an Arkansas corporation that does business in many states, including Alabama, Arkansas, Florida, Georgia, Mississippi, Louisiana, Oklahoma, and Texas. *Id.*

218. *Id.* at 837.

219. The arbitration agreement states in part: "any controversy or claim . . . arising out of or relating to the interpretation, performance or breach of any provision of this agreement shall be settled exclusively by arbitration." *Id.*

220. *Id.*

221. *Id.*

pel arbitration pursuant to the arbitration clause in the plan and section 2 of the FAA.²²² The trial court denied the motion, and Terminix and Terminix International appealed.

The Supreme Court of Alabama upheld the denial of the motion to stay the proceedings.²²³ They based their holding on an Alabama statute which makes written, pre-dispute arbitration agreements invalid and unenforceable.²²⁴ Although the Alabama court recognized that arbitration agreements voluntarily entered into and contained in a contract that involves interstate commerce preempt this state statute,²²⁵ this contract did not meet the "involving commerce" requirement of section 2, and the FAA did not apply.²²⁶ Employing the "contemplation of the parties" test to evidence "a transaction involving commerce,"²²⁷ the court found the evidence proffered by Terminix insufficient to "establish that the parties contemplated substantial interstate activity" when they entered the plan.²²⁸ In so

222. *Id.*

223. 628 So. 2d at 357.

224. *Id.* at 355. The Alabama statute, ALA. CODE § 8-1-41(3) (1993), states that any agreements to forego a judicial forum through an arbitration clause is "invalid and unenforceable."

225. *Id.*

226. *Id.* at 356-57.

227. The Alabama Supreme Court followed their recent decision that adopted the "contemplation of the parties" standard for determining the involvement of interstate commerce. See *Ex parte Jones*, 628 So. 2d 316 (Ala. 1993) (citing *Ex parte Warren*, 548 So. 2d 157 (Ala. 1989), *cert. denied*, 493 U.S. 998 (1989) (citing *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382 (2nd Cir.), *cert. denied*, 368 U.S. 817 (1961))). The *Metro* court held that in determining the involvement of interstate commerce "[t]he significant question, therefore, is not whether, in carrying out the terms of the contract, the parties *did* cross state lines, but whether, at the time they entered into it and accepted the arbitration clause, they contemplated substantial interstate activity." 278 F.2d at 387 (Lumbard, C.J., concurring). In adopting this standard, the Alabama Supreme Court rejected their prior holding which established a "slightest nexus" standard. See *Ex parte Costa & Head (Atrium), Ltd.*, 486 So. 2d 1272 (Ala. 1986); see also *Snyder v. Smith*, 736 F.2d 409, *cert. denied*, 469 U.S. 1037 (1984) (7th Cir. 1984). By adopting the "contemplation" standard, the Alabama Supreme Court condoned the

result . . . that a party unable to prove his contracting partner's state of mind at the time the parties entered into the contract will not be able to avail himself of the arbitration process in Alabama even though both parties signed a contract agreeing to submit their disputes to just such an arbitration tribunal.

Thomas D. Applewhite, *Ex parte Jones: But did you Contemplate Substantial Interstate Activity?*, 45 MERCER L. REV. 1423, 1428 (1994).

228. 628 So. 2d at 356. In its holding, the court reviewed the evidence presented

holding, the court limited the scope of the FAA and raised questions about how to apply the Act. Thus, the issue presented to the United States Supreme Court was whether section 2 of the FAA “should be read broadly, extending the Act’s reach to the limits of Congress’ Commerce Clause power? Or do . . . ‘involving’ and ‘evidencing’ . . . significantly restrict the Act’s application?”²²⁹

B. *The Majority Opinion*

In delivering the opinion for the majority, Justice Breyer held that section 2 should be read broadly to extend the Act’s reach to the limits of Congress’ Commerce Clause power.²³⁰ In so doing, he explained the scope of “involving commerce” and declared that the “commerce-in-fact” test is to be the standard by which a party evidences a transaction involving commerce.²³¹

Justice Breyer laid the groundwork for the opinion by relying on past precedent to state that “the basic purpose of the [FAA] is to overcome courts’ refusals to enforce agreements to arbi-

by Terminix. *Id.* at 356-57. First, the fact that the bond stated it was executed in Tennessee was held not to be determinative in that it was insufficient merely to show that one or more parties to the contract were located in another state. *Id.* The court also considered the language in the plan stating it was subject to federal regulation. This was also deemed insufficient to show that the parties contemplated substantial interstate activity, particularly because it did not put the parties on notice of the likelihood of such activity. *Id.* Terminix also offered evidence that Gwin, the original owner of the house, stated he wanted to go with a “national” company. The court attributed this comment to the desire to gain the security associated with large companies, and not contemplation of substantial interstate activity. *Id.* The final piece of evidence proffered was the theory that interstate supplies would be required for performance of the bond obligations. Although some construction contracts would suffice under this theory, the court decided this contract did not because the interstate activity involved was not “so great that it cannot reasonably be said that the parties failed to contemplate substantial interstate activity when they entered into the contract.” *Id.* Without directly addressing the issue, the court implied that “some materials used in fulfilling the bond obligations may have come from out-of-state suppliers” is not “substantial” enough to satisfy the “substantial interstate activity” requirement for the test. *Id.*

229. 115 S. Ct. at 836.

230. 115 S. Ct. at 838-43.

231. *Id.* at 838 (citing *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (The “basic purpose of the Federal Arbitration Act is to overcome courts’ refusals to enforce agreements to arbitrate”)); see also *Prima Paint v. Flood & Conklin*, 388 U.S. 395 (1967) (holding that the Act is based upon the Commerce Clause powers of Congress).

trate.²³² He then reiterated the conclusion that the FAA is not based upon Congress' power to "ordain and establish" federal courts,²³³ but rather is based on the Commerce Clause.²³⁴ He concluded the groundwork with the affirmation of *Southland's* holding that the FAA preempts state law, and that state courts cannot apply state statutes that invalidate arbitration agreements.²³⁵ With these three legal background items presented, Justice Breyer defended the *Southland* decision. Despite the insistence of Justice Scalia, Justice Thomas, Dobson, and twenty state attorneys general to the contrary, the Court reaffirmed that the holding in *Southland* was correct and would not be overruled.²³⁶

Justice Breyer offered four reasons why the decision would not be overturned. First, the *Southland* Court considered similar arguments against preemption but decided that the FAA preempted state law to the contrary.²³⁷ Secondly, he stated that "nothing significant" had happened since *Southland*.²³⁸ He offered two examples of situations, the absence of which might be considered significant. The first was that no later cases had eroded the *Southland* authority.²³⁹ To the contrary, *Perry* and *Volt* both reaffirmed the *Southland* holding.²⁴⁰ He also noticed that no unforeseen practical problems had arisen, but did not define what they might have been.²⁴¹ His third reason why the Court would not overrule *Southland* was that private parties had written contracts relying on the holding in *Southland*.²⁴² His final reason was that Congress had passed legislation extending the scope of arbitration.²⁴³ To support this reason, Justice Breyer referred to 9 U.S.C. § 15 which

232. 115 S. Ct. at 836.

233. U.S. CONST. art. III, § 1.

234. 115 S. Ct. at 838, (citing *Prima Paint*, 388 U.S. 395, 405 (quoting H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924))).

235. *Id.* (citing *Southland Corp. v. Keating*, 465 U.S. 1, 15-16 (1983)).

236. *Id.* at 838-39, 844-45.

237. *Id.*

238. *Id.*

239. *Id.*

240. See *Volt Info. Sciences Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989); *Perry v. Thomas*, 482 U.S. 483 (1987).

241. 115 S. Ct. at 839.

242. *Id.*

243. *Id.*

eliminated the Act of State doctrine as a bar to arbitration, and 9 U.S.C. §§ 201-208 regarding international arbitration.²⁴⁴

The majority then proceeded to the two basic interpretive questions. The Court's answers to these questions established that section 2 of the FAA should be read broadly to extend the Federal Arbitration Act's reach to the limits of Congress' Commerce Clause power.²⁴⁵

1. The Scope of Section 2's "Involving Commerce" Language

The Court first addressed the interpretive question regarding section 2's "involving commerce" language. The Court held that the "involving commerce" language signals the full exercise of the Commerce Clause's constitutional power.²⁴⁶ This holding was premised upon the idea that "involving commerce" should be interpreted as broadly as "affecting commerce" which normally signals full exercise of Commerce Clause power.²⁴⁷

To reach this conclusion, Justice Breyer presented a strong argument that relied upon simple statutory and judicial interpretation. Justice Breyer first turned to the language of other federal statutes that used "involving commerce" to discern the meaning intended in the FAA. Surprisingly, there are no other statutes that use the word "involving" to describe an interstate commerce relation.²⁴⁸ He then turned to the dictionary definition of "involve" which incorporated "affect" into its definition.²⁴⁹ Strengthening his argument, he proceeded to show that through the FAA's legislative history Congress intended such an expansive interpretation.²⁵⁰ He reiterated the "expansive legislative intent" as evidenced by the excerpts taken from

244. *Id.*

245. *Id.* at 841.

246. *Id.*

247. See Civil Rights Act of 1964, 42 U.S.C. § 2000a(b) (1988); National Labor Relations Act, 29 U.S.C. § 160(a) (1988).

248. Allied-Bruce Terminix, 115 S. Ct. at 839. (The Act's "control over interstate commerce reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce.")

249. *Id.* (citing V Oxford English Dictionary 466 (1st ed. 1933) "providing examples dating back to the mid-nineteenth century, where 'involve' means to 'include or affect . . . in operation'").

250. *Id.*

the Congressional Record. The House Report stated that the Act's "control over interstate commerce reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce."²⁵¹ In addition, the majority restated Representative Graham's comments that the Act "affects contracts relating to interstate subjects and contracts in admiralty."²⁵² In support of its position, the Court presented the fact that section 1 of the FAA defines "commerce" "in the language of the Commerce Clause itself."²⁵³

Perhaps the strongest argument the Court made came from its review of past precedent and the basic purpose of the Act. Past precedent established that the Act's reach "coincided with that of the Commerce Clause."²⁵⁴ The Court noted that the holdings had not been overruled. The purpose of the Act, as Justice Breyer stated, was to "put arbitration provisions on 'the same footing' as a contract's other terms."²⁵⁵ The Court reasoned that limiting the language "involving commerce" would create a "new, unfamiliar test" that would create litigation from the very statute that was enacted to avoid litigation.²⁵⁶ This pointed to the conclusion that "involving" should be given the same meaning as "affecting." Support for the majority's position also prevailed in *Bernhardt*,²⁵⁷ which seemed to define "involving commerce" in a similar fashion.²⁵⁸ Based on this support, the Court held that the language of the FAA's section 2 should be interpreted broadly.²⁵⁹ "Involving commerce" was not in-

251. H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924).

252. 65 CONG. REC. 1931 (1924). Representative Graham of Pennsylvania submitted the report on, and was the primary proponent of the FAA. His report was heavily relied upon by the Court in this decision and prior holdings to discern legislative intent.

253. *Allied-Bruce Terminix*, 115 S. Ct. at 840.

254. *Id.* at 840 (citing *Perry v. Thomas*, 482 U.S. 490 (1987); *Southland Corp. v. Keating*, 465 U.S. 1, 14-15 (1983); *Prima Paint v. Floyd & Conklin*, 388 U.S. 395, 407 (1967)).

255. 115 S. Ct. at 840, (citing *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974)).

256. *Id.* The Court's position on this subject could also have been supported by Congressman Graham's assurances to Congress that the Act would not create any "new principle of law" or "new legislation." 65 CONG. REC. 1931 (1924).

257. 350 U.S. 198 (1955).

258. See *supra* notes 98-93, see also *Cohen*, *supra* note 4, at 277.

259. 115 S. Ct. at 840.

tended to create a "new, unfamiliar test" but could reasonably be interpreted to coincide with "affecting commerce."²⁶⁰

2. Standard to Determine Applicability of Section 2 of the FAA

The second interpretive question involved the "evidencing a transaction" language.²⁶¹ The Court recognized the difficulty in choosing an interpretation,²⁶² but decided that the "commerce-in-fact" test should be chosen as the definitive standard by which to apply the FAA. The Court found the "commerce-in-fact" test "more faithful to the statute" than the "contemplation of the parties" test.²⁶³ In so holding, Justice Breyer reasoned that the "contemplation" test is "anomalous" to the Act's basic purpose of enforcing arbitration agreements and avoiding unnecessary litigation.²⁶⁴ The subjective nature of the "contemplation" test, he noted, would undoubtedly result in additional litigation regarding what was, or was not, "contemplated."²⁶⁵ The resulting litigation would be contrary to the purpose of the Act.²⁶⁶ The Court further reasoned that the "contemplation" test would place the validity of an arbitration agreement upon the "happenstance" that the parties would actually mention interstate commerce when entering the contract or add a reference to interstate commerce.²⁶⁷ It was also noted that the "contemplation" test would make unenforceable the provision of section 2 that covers "an agreement in writing to submit to arbitration *an existing controversy arising out of such contract.*"²⁶⁸

260. *Id.*

261. 9 U.S.C. § 2 (1988).

262. 115 S. Ct. at 841.

263. *Id.*

264. *Id.*

265. *Id.*

266. *Id.*

267. *Id.*

268. *Id.* at 842 (emphasis added). If such a test was allowed, as Justice Breyer noted, an arbitration agreement made after the parties entered into the contract could potentially be passed over for FAA application. *Id.* This seems to fly in the face of congressional intent to enforce arbitration agreements. See H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924). Further, nothing in the legislative history suggests that such a result should occur since the arbitration agreements discussed were not qualified, with the exception that they be in writing and be contained in "any maritime transaction or a contract evidencing a transaction involving commerce." 9 U.S.C. § 2

Following this reasoning, the Court stated that the "commerce-in-fact" test is permitted by the statute's language.²⁶⁹ Not only did that interpretation avoid the anomalous effects listed above, but Justice Breyer held that it was in accord with the language of the statute and the legislative history.²⁷⁰ Therefore, despite one minor interpretive issue,²⁷¹ the "commerce-in-fact" test was deemed the most "faithful" to the FAA and was adopted by the Court.²⁷²

C. *The Concurring and Dissenting Opinions*

The remaining justices disagreed with the majority's holding that the FAA applies to state courts.²⁷³ Justice O'Connor, while supporting Justice Breyer in his analysis of the language "involving commerce" and "evidencing a transaction," disagreed with the majority's summarization of Congress' intent.²⁷⁴ Justice Scalia and Justice Thomas dissented from the opinion for the sole reason that they believed *Southland* should be overruled.²⁷⁵ They both disagreed with its holding that the FAA applies to state courts and withdraws state power requiring a

(1988).

269. 115 S. Ct. at 842.

270. *Id.* Justice Breyer cited testimony that Congress "wanted to 'get a Federal law' that would 'cover' areas where the Constitution authorized Congress to legislate, namely 'interstate and foreign commerce and admiralty.'" *Id.* (citing *Joint Hearings on S. 1005 and H.R. 646 before the Subcommittees of the Committees on the Judiciary*, 68th Cong., 1st Sess., 7 (1924)).

271. The Court noted that the "commerce-in-fact" test would leave "little work for the word 'evidencing' (in the phrase 'evidencing a transaction') to perform, for every contract evidences a transaction." *Id.* However, Justice Breyer considered that Congress, perhaps, did not intend it to do much work. Given Congress' intent to enforce arbitration agreements and their use of the Commerce Clause language, Justice Breyer's hypothesis is reasonable. *Id.*

272. *Id.* at 843.

273. Justice O'Connor concurred with the majority's holding. *Id.* at 843-44. She agreed with Justice Breyer in his interpretation of "involving commerce" and "evidencing a transaction," but did not feel that the FAA should apply to state courts. *Id.* However, she did concede that the ruling should be upheld under the doctrine of *stare decisis*. Justice Scalia dissented and addressed only the decision in *Southland*. *Id.* at 844-45. He did not address the issues of "involving commerce" or "evidencing a transaction" because if *Southland* were to be overruled, the FAA would not apply to this state court case. *Id.* Justice Thomas, with whom Justice Scalia also joined, similarly dissented. *Id.* at 845-51.

274. *Id.*

275. *Id.*

judicial forum. In light of *stare decisis* and past holdings, the majority found their arguments unpersuasive.²⁷⁶

V. ANALYSIS, REACTION, AND EFFECT OF *ALLIED-BRUCE TERMINIX* DECISION ON SECTION 2 OF THE FAA

Once the issues of *Allied-Bruce Terminix* were addressed and decided, the focus turned from the United States Supreme Court to the legislature, lower courts, and commentators to determine its validity. This comment advances the opinion that the majority's holding was correct. It also addresses the reactions of Congress, the lower courts, and legal commentators. Finally, it turns to the presumed impact the decision will have on issues affecting arbitration and section 2 of the FAA.

A. *Analysis of the Majority's Decision in Allied-Bruce Terminix*

The majority's opinion addressed issues that had been debated or left unaddressed since the enactment of the FAA in 1925. The implications of the Court's decision may be more far-reaching than the majority supposed.²⁷⁷ However, it is posited that the majority was correct in its decision regarding the scope and applicability of the FAA.

1. Scope of "Involving Commerce"

The majority in *Allied-Bruce Terminix* reaffirmed the decisions of *Southland* and *Perry*, both of which held that the FAA was enacted under the Commerce Clause authority delegated to Congress.²⁷⁸ This was the correct holding under the doctrine of *stare decisis*.

276. See *infra* part V.A.1.a.

277. See *infra* part V.D.

278. *Southland Corp. v. Keating*, 465 U.S. 1 (1983); *Perry v. Thomas*, 482 U.S. 483 (1987).

a. The Doctrine of Stare Decisis

The doctrine of stare decisis requires the Court to adhere to decided cases.²⁷⁹ Without "special justification" there should be no departure from this doctrine.²⁸⁰ The Court in *Patterson v. McLean Credit Union* gave two examples of "special justifications" which have required statutory precedents to be overruled. The first was an "intervening development of the law, through either the growth of judicial doctrine or further action taken by Congress."²⁸¹ In *Allied-Bruce Terminix*, it was clear that the judicial doctrine that had grown was the expansion of the FAA.²⁸² It was also clear that Congress has acted in favor of the *Southland* decision.²⁸³ Therefore, this example did not offer a "special justification" to avoid stare decisis. The second example proffered by the *Patterson* Court is "where the later law has rendered the decision irreconcilable with competing legal doctrines or policies."²⁸⁴ Again, the later law supported the *Southland* decision.²⁸⁵ Therefore, the Court was correct in holding that there was no "special justification" to avoid stare decisis in *Allied-Bruce Terminix*.

In addition, "the burden borne by the party advocating the abandonment of an established precedent is greater where the Court is asked to overrule a point of statutory construction."²⁸⁶ Justice Thomas presents the "necessity of 'preserv[ing] state autonomy in state courts'" as a special justification.²⁸⁷ However, the Court has never found "state autonomy" to be a "special justification." Only one Supreme Court case has even had a Justice make such an argument.²⁸⁸ It is interesting to note

279. See *Patterson v. McLean Credit Union*, 491 U.S. 164, 172-73 (1989). This decision was cited by Justice O'Connor in her discussion regarding the doctrine of *stare decisis* and the *Southland* decision. 115 S. Ct. at 844.

280. *Patterson*, 491 U.S. at 172-73 (citing *Arizona v. Runsey*, 467 U.S. 203, 212 (1984)).

281. *Id.* at 173.

282. See *supra* part III.A-G.

283. See *supra* note 247 (discussing Congress enacting additional laws).

284. *Patterson*, 491 U.S. at 173.

285. See *supra* part III.D.

286. *Patterson*, 491 U.S. at 172.

287. *Allied-Bruce Terminix*, 115 S. Ct. at 850.

288. See *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 577-

that although Justice O'Connor made the argument in *Garcia*, she did not join Justice Thomas in his position in *Allied-Bruce Terminix*. Therefore, the majority correctly found "state autonomy in state courts" not to be a "special justification" to avoid stare decisis in *Allied-Bruce Terminix*, and the principles of *Southland* should, therefore, have been upheld.

b. Preemption

Once the doctrine of stare decisis was correctly relied upon by the Court, its attention could then be focused on analyzing previous holdings which supported the majority's position that section 2 of the FAA preempts state anti-arbitration law.²⁸⁹ The FAA, specifically section 2, had been declared a substantive law resting upon the Commerce Clause.²⁹⁰ As such, it was applicable to state courts and would preempt state law that "conflicts with federal law—that is, to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"²⁹¹ Therefore, a statute such as Alabama's that "require[d] a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration"²⁹² is preempted by section 2 of the FAA, as was correctly held by the majority.

2. Standard to Apply to Section 2: The "Commerce-in-Fact" Test Versus the "Contemplation of the Parties" Test

Given the legislative intent to enact a statute that would enforce arbitration agreements, and the intended far reaching effects of the Act,²⁹³ the Court's holding is reasonable and cor-

89 (1985) (O'Connor, J., dissenting).

289. Although the preemptive application of section 2 has been decided directly, there has been no holding that sections 3 and 4 apply in state courts. *See supra* notes 33-36, 195, 213-14. Such a discussion, although intriguing and controversial, is outside the scope of this casenote.

290. *Southland v. Keating*, 465 U.S. 1, 10 (1983).

291. *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 477 (1989).

292. *Southland*, 465 U.S. at 10; *see also*, 489 U.S. at 478; *Perry v. Thomas*, 482 U.S. 483, 490 (1987).

293. H.R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924) (the Act's "control over interstate commerce reaches not only the actual physical interstate shipment of goods

rect.²⁹⁴ As noted in past decisions, section 2 of the FAA has been given a broad interpretation.²⁹⁵ Holding that the language of section 2 is actually a limiting factor to the Act would be counterproductive to the "congressional declaration of a liberal federal policy favoring arbitration agreements"²⁹⁶ and the Act's purpose of enforcing arbitration agreements evidencing a transaction involving interstate commerce.²⁹⁷

The holding is supported by prior Supreme Court holdings. In both *Bernhardt* and *Prima Paint*, the Court addressed contracts "involving commerce."²⁹⁸ In so doing, the Court looked to what had transpired between the parties through the contract. In *Bernhardt*, had the Court found that the parties were "engaging in activity that *affected commerce*" the "involving commerce" requirement would have been met.²⁹⁹ The Court reviewed whether *Bernhardt* had in fact engaged in an activity involving commerce "while performing his duties under the employment contract."³⁰⁰ The Court did not question whether the parties contemplated such interstate commerce activity upon entering the contract. It can reasonably be assumed that the absence of an inquiry into whether the parties contemplated interstate commerce raises the presumption that it was not relevant.³⁰¹

In *Prima Paint*, the Court conducted a similar analysis.³⁰² The Court reviewed the transaction between the parties, observed that it was "inextricably tied to" interstate commerce, and found the contract evidenced "a transaction involving com-

but also contracts relating to interstate commerce").

294. See also *Snyder v. Smith*, 736 F.2d 409, 417-18 (7th Cir. 1984) (supporting the broad interpretation of "involving commerce" and linking "involving" with "affecting").

295. See *Perry*, 482 U.S. 483 (1987); *Southland*, 465 U.S. 1 (1983).

296. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1982). The Second Circuit combined this federal policy favoring arbitration agreements with a strong policy favoring arbitration of contract disputes to come to the conclusion that "evidencing a transaction involving commerce" should be read broadly. See *Snyder*, 736 F.2d at 417.

297. H.R. REP. NO. 96, 68th Cong., 1st Sess., 1 (1924).

298. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967); *Bernhardt v. Polygraphic Co. of Am., Inc.*, 350 U.S. 198 (1955).

299. *Bernhardt*, 350 U.S. at 198 (emphasis added).

300. *Id.*

301. *Snyder v. Smith*, 736 F.2d 409, 417 (7th Cir. 1984).

302. *Prima Paint*, 388 U.S. at 401.

merce.”³⁰³ Again, the contemplation of the parties was not relevant to the decision.³⁰⁴ Combining this reasoning with the Court’s holding in *Moses H. Cone* that “any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability,”³⁰⁵ and Justice Marshall’s observation in *Perry* that the FAA “embodies Congress’ intent to provide for the enforcement of arbitration agreements *within the full reach of the Commerce Clause*,”³⁰⁶ supports the *Allied-Bruce Terminix* holding.

In addition, there is no support in the legislative history, or the language of the Act itself, which holds the “contemplation of the parties” test applicable. Attached to the word “contemplation” was another important word in the test as applied in Alabama.³⁰⁷ Alabama required the parties to contemplate “*substantial* interstate activity” at the time the parties entered into the contract and accepted the arbitration clause.³⁰⁸ The words “contemplation” and “substantial” added requirements to section 2 that were not included in the Act nor were mentioned in legislative history.³⁰⁹ The Act defines “involving commerce” in

303. *Id.*

304. *Id.* An interesting note that strengthens this position is found in footnote 6 of the *Prima Paint* decision. *Id.* at 401 n.6. The Court provided that the affidavit relied upon by the court of appeals mentioned that “[t]he agreement . . . contemplated and intended an orderly transfer of the assets of the defendant to the plaintiff, and further contemplated and intended that the defendant would consult, advise, assist and help the plaintiff.” *Id.* (emphasis added). With this “contemplation” language noted by the Court, it is reasonable to infer that if the Court had intended to use a “contemplation” test, it would have summarily stated that the test was met by the language of *Prima Paint*’s affidavit. However, they did not mention the contemplation of the parties and it was not relevant to the decision.

305. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983) (emphasis added). The Court noted that a defense to arbitrability should be resolved in favor of arbitration. *Id.* Applying this argument to *Allied-Bruce Terminix*, it seems that the problem of no “contemplation” as a defense versus the application of the “commerce-in-fact” test should be resolved in favor of arbitration, thereby making the “commerce in fact” test the preferred standard.

306. *Perry v. Thomas*, 482 U.S. 483, 490 (1987).

307. *Ex parte Jones*, 628 So. 2d 316 (Ala. 1993).

308. *Id.* at 318 (emphasis added).

309. See H.R. REP. NO. 96, 68th Cong., 1st Sess. 1 (1924); 65 CONG. REC. 1931 (1924); *Joint Hearings on S. 1005 and H.R. 646 before the Subcommittees of the Committees on the Judiciary*, 68th Cong., 1st Sess. 1 (1924); 9 U.S.C. § 1 (defining “commerce”).

terms of the Commerce Clause.³¹⁰ It does not mention that such commerce must be contemplated at the time of the agreement or be any more "substantial" than it must be to fall under the Commerce Clause. The legislative history of the Act provides that Congress' intent was to pass legislation that covered contracts regarding actual physical interstate commerce and also contracts merely "relating to interstate commerce."³¹¹ This expansive goal cannot be met by applying Alabama's limiting standards and the Court was correct in its holding.

In rejecting the "contemplation of the parties" test, the Court explicitly avoided interpreting "involving commerce" narrowly for fear of creating a new "unfamiliar" test. Given the fact that Congressman Graham stressed to Congress that the Act would not create any "new principle of law" or "new legislation,"³¹² this reasoning is correct. Also, the Court's decision not to interpret "involving commerce" narrowly is correct given the effect such an interpretation would have on arbitration. A narrow interpretation would require either the parties or the courts to determine what "involving commerce" should mean. Such a result would unnecessarily complicate the enforcement of arbitration agreements and breed litigation—the very occurrence which Congress sought to avoid through enacting the FAA.

The "contemplation of the parties" test was also dismissed due to its effect on arbitration agreements made after the parties entered into contracts. If a "contemplation of the parties" test were allowed, then, as Justice Breyer noted, an arbitration agreement made after the parties entered into the contract would potentially be passed over for FAA application.³¹³ This seems appropriate considering congressional intent to enforce arbitration agreements.³¹⁴ Further, there is nothing in the legislative history to suggest that such a result should occur since the arbitration agreements included in section 2 were only qualified with the requirements that they be in writing and be

310. See *supra* notes 28 and accompanying text.

311. H.R. REP. NO. 96, 68th Cong., 1st Sess. 1 (1924).

312. 65 CONG. REC. 1931 (1924).

313. *Allied-Bruce Terminix*, 115 S. Ct. at 842.

314. See H.R. REP. NO. 96, 68th Cong., 1st Sess. 1 (1924).

contained in "any maritime transaction or a contract evidencing a transaction involving commerce."³¹⁵

B. *Congressional and Judicial Reaction to Allied-Bruce Terminix*

Although the majority in *Allied-Bruce Terminix* met with a strong dissent, legislative and judicial reactions to the decision have been positive. There has been no action by Congress to restrict the enforcement of arbitration agreements or to define the ambiguous terms "involving commerce" or "evidencing."³¹⁶ Regarding judicial reaction, there have been no cases to date that have challenged the holding in *Allied-Bruce Terminix* or have called for a reversal of cases relied on by the majority.

1. State Courts

The State courts have consistently followed the *Allied-Bruce Terminix* decision without questioning or expanding its holding.³¹⁷ Most state court cases that cite *Allied-Bruce Terminix* involve the issue of state statute preemption by the FAA. Many of the cases involve state arbitration laws addressing arbitra-

315. 9 U.S.C. § 2 (1988).

316. Congress has recently introduced an amendment to the FAA which would establish, within the FAA, the Civil Rights Procedures Protection Act. 141 CONG. REC. S2268-03, 2271 (statement of Rep. Feingold). Representative Feingold introduced a bill which "mirrors a House bill introduced [in 1994] by Representatives Patricia Schroeder, Edward Markey, and Marjorie Margolies-Mezvinsky." *Id.* The bill would amend the FAA, among other statutes, to extend protection of the bill to "claims of unlawful discrimination that arise under State or local law, and other Federal laws that prohibit job discrimination." *Id.* The bill would specifically amend Title 9 of the United States Code by adding "(b)" to section 14 of the FAA. Section 14(b) would read: "(b) This chapter shall not apply with respect to a claim of unlawful discrimination in employment if such claim arises from discrimination based on race, color, religion, sex, national origin, age, or disability." *Id.* Rep. Feingold assured the President of the United States, upon introduction of this bill, that it was "in no way intended to bar the use of voluntary arbitration. . . . In fact, I strongly support the use of voluntary alternative dispute resolution methods as a way of reducing the caseloads of civil and criminal courts where appropriate." *Id.*

317. *See, e.g.,* Engalla v. Permanente Medical Group, Inc., 43 Cal. Rptr. 2d 621 (1995); Columbus Anesthesia Group v. Kutzner, 459 S.E.2d 422 (Ga. Ct. App. 1995); Tim Huey Corp. v. Global Boiler and Mechanical, Inc., 649 N.E.2d 1358 (Ill. App. Ct. 1995); Johnson v. Piper Jaffray, Inc., 530 N.W.2d 790 (Minn. 1995); Mr. Mudd, Inc. v. Petra Tech, Inc., 892 S.W.2d 389 (Mo. Ct. App. 1995).

tion procedure; not statutes making arbitration agreements unenforceable, such as the Alabama statute in *Allied-Bruce Terminix*. One such case involved a Georgia arbitration statute which required initials beside terms and conditions of employment in a contract before the term could be enforced.³¹⁸

The state courts also cite *Allied-Bruce Terminix* for the proposition that the scope of the FAA is as broad as Congress' Commerce Clause authority, and that the appropriate test to determine whether the FAA, and specifically section 2, applies to arbitration agreements is the "commerce-in-fact" test.³¹⁹ In the Georgia case discussed above, the court found that when agreements "involve interstate commerce, the federal law applies to enforce the arbitration provision."³²⁰ They reiterated that "involving commerce" is the "functional equivalent of the phrase 'affecting commerce,' which normally signals Congress' intent to exercise its commerce power to the full[est]."³²¹ However, the court did not find that the facts evidenced activity involving interstate commerce.³²² Specifically, the case involved the "[c]ontribution of equipment to a professional corporation after its formation" and the court found that it did "not affect interstate commerce within the meaning of the [FAA]."³²³

2. Federal Courts

The Federal courts have similarly followed the holding in *Allied-Bruce Terminix*.³²⁴ There are no cases that attempt to expand upon the holding or question its reasoning. The majority of cases citing *Allied-Bruce Terminix* do so to establish the

318. *Columbus Anesthesia Group v. Kutzner*, 459 S.E.2d 422 (Ga. Ct. App. 1995) (addressing Georgia Arbitration statute OCGA § 9-9-2(c)(9)).

319. *Engalla*, 43 Cal. Rptr. 2d at 632; *Columbus*, 459 S.E.2d at 423-24; *Mr. Mudd*, 892 S.W.2d at 392.

320. *Columbus*, 459 S.E.2d at 423.

321. *Id.* at 423-24 (citing *Allied-Bruce Terminix Co. v. Dobson*, 115 S. Ct. 834 (1995)).

322. *Id.* at 424.

323. *Id.*

324. *Gingiss Int'l. Inc. v. Bormet*, 58 F.3d 328 (7th Cir. 1995); *Juno SRL v. S/V Endeavour*, 58 F.3d 1 (1st Cir. 1995); *Williams v. CIGNA Fin. Advisors*, 56 F.3d 656 (5th Cir. 1995); *Jain v. de Mere*, 51 F.3d 686 (7th Cir. 1995); *McKee v. Home Buyers Warranty Corp. II*, 45 F.3d 981 (5th Cir. 1995); *McDonald v. Rodriguez*, 184 B.R. 514 (S.D. Tex. 1995).

applicability of the FAA.³²⁵ These cases follow *Allied-Bruce Terminix's* reasoning that the FAA applies to arbitration agreements in contracts "involving commerce," that Congress intended the phrase "involving commerce" to have as broad a reach as Congress is given under the Commerce Clause, and that the "commerce-in-fact" test governs the review of whether a contract was "involving commerce."³²⁶

3. United States Supreme Court

Three months after the Court decided *Allied-Bruce Terminix*, the Supreme Court decided another case involving section 2 of the FAA. *Mastrobuono v. Shearson Lehman Hutton, Inc.*,³²⁷ involved a complaint from a client of Shearson Lehman Hutton (Shearson), a securities brokerage and investment firm, alleging that the firm had mishandled their account. Pursuant to an arbitration agreement contained in the parties' contract,³²⁸ the parties entered into arbitration. Shearson argued during the proceedings that the arbitrator had no authority to award puni-

325. *Gingiss Int'l Inc. v. Bormet*, 58 F.3d 328 (7th Cir. 1995); *Williams v. CIGNA Fin. Advisors*, 56 F.3d 656 (5th Cir. 1995); *McKee v. Home Buyers Warranty Corp. II*, 45 F.3d 981 (5th Cir. 1995); *McDonald v. Rodriguez*, 184 B.R. 514 (S.D. Tex. 1995).

326. *Gingiss*, 58 F.3d at 328 (holding that franchise agreement between two companies to open store in another state "involved commerce"); *Williams*, 56 F.3d at 659 (citing *Allied-Bruce Terminix* for the proposition that "Congress exercised its 'commerce power to the full' in enacting § 2 of the FAA"); *McKee*, 45 F.3d at 984 (applying FAA to contract "involving commerce" where Louisiana couple bought house and sued out-of-state warranty company); *McDonald*, 184 B.R. at 516 (giving "involving commerce . . . a broad meaning" and proposition that the contract in dispute was "affecting commerce").

327. 115 S. Ct. 1212 (1995).

328. The arbitration agreement and choice of law clause read, in part:

This agreement shall inure to the benefit of your [Shearson's] successors and assigns shall be binding on the undersigned, my [petitioner's] heirs, executors, administrators and assigns, *and shall be governed by the laws of the State of New York*. Unless unenforceable due to federal or state law, any controversy arising out of or relating to [my] accounts, to transactions with you, your officers, directors, agents and/or employees for me or to this agreement or the breach thereof, *shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange Inc. as I may elect.*

115 S. Ct. at 1216 n.2 (emphasis added).

tive damages.³²⁹ However, the arbitrator awarded them to Mastrobuono despite Shearson's protests.³³⁰ Shearson argued that the contract contained a choice of law clause, the clause stated that New York law would apply, and that New York law clearly established that arbitrators cannot award punitive damages.³³¹ Shearson offered *Garrity v. Lyle Stuart, Inc.*,³³² a New York Court of Appeals case, to support its position that awarding punitive damages can only be done in judicial tribunals. Mastrobuono's rebuttal to Shearson's argument was that the arbitration agreement did not specifically preclude punitive damage awards and that the rules of NASD arbitrators expressly state that arbitrators are allowed to award punitive damages.³³³

The Court followed Mastrobuono's argument, finding that, although the conflict of law clause and the arbitration agreement differ in their treatment of punitive damages, the punitive damage award should be enforced.³³⁴ The Court noted that *Allied-Bruce Terminix* was a similar case in that the petitioner sought the Court's ruling that the FAA preempts state law.³³⁵ Although the Court reached a result in *Mastrobuono* similar to the decision in *Allied-Bruce Terminix*, the reasoning was different. In *Allied-Bruce Terminix*, the Court "upheld the enforceability of [the parties'] predispute arbitration agreement governed by Alabama law, even though an Alabama statute provide[d] that arbitration agreements [were] unenforceable."³³⁶ In *Mastrobuono*, the Court did not hold that the FAA preempted the New York law regarding punitive damage awards. Instead, the Court reasoned that the agreement was "ambiguous" as to the parties' intentions regarding punitive damages and that such ambiguities should be "resolved in favor of arbitration."³³⁷ Therefore, the punitive damage award should have

329. *Id.* at 1214.

330. *Id.*

331. *Garrity v. Lyle Stuart, Inc.*, 353 N.E.2d 793 (N.Y. 1976).

332. *Id.*

333. The section of the NASD arbitration rules addressing punitive damages states that "[t]he issue of punitive damages may arise with great frequency in arbitrations. Parties to arbitration are informed that arbitrators can consider punitive damages as a remedy." 115 S. Ct. at 1218 (emphasis added).

334. *Id.* at 1219.

335. *Id.* at 1215.

336. *Id.* at 1215.

337. *Id.* at 1218 (citing *Volt Info. Sciences, Inc. v. Board of Trustees of Leland*

been enforced absent express intentions of the parties to the contrary. The *Allied-Bruce Terminix* decision was neither expanded, questioned, or even substantially relied upon in *Mastrobuono*.

C. Legal Commentators' Reaction to the Allied-Bruce Terminix Decision

Thus far, there has been virtually no reaction by legal commentators to the *Allied-Bruce Terminix* decision. The few publications that address the combined issues of arbitration, section 2 of the FAA, and the *Allied-Bruce Terminix* decision are supportive of the decision and its effects on arbitration.³³⁸ These publications do not disagree with the Court's decisions or reasoning. The publication from the Dispute Resolution Journal reviews the Court's *Allied-Bruce Terminix* decision and views it as "a major victory for proponents of ADR."³³⁹ The publication from the Ohio State Journal on Dispute Resolution outlines the evolution of commercial arbitration and proposes a model to follow for the arbitration process.³⁴⁰ The author describes the current arbitration process and related issues, citing *Allied-Bruce Terminix* for support in issues that had not been directly addressed by the case itself.³⁴¹ Both publications are silent as to the validity of the *Allied-Bruce Terminix* decision and reasoning.

Stanford Junior Univ., 489 U.S. 468, 476 (1989)).

338. See Stanley D. Bynum et al., *The Supreme Court's Decision on Terminix Reaffirms the Scope of the FAA*, 50 DISP. RESOL. J. 8 (1995); Stephen Hayford & Ralph Peeples, *Commercial Arbitration in Evolution: An Assessment and Call for Dialogue*, 10 OH. ST. J. ON DISP. RESOL. 343 (1995).

339. Bynum, et al., *supra* note 337.

340. Hayford & Peeples, *supra* note 338.

341. *Id.* at 347 n.8 (noting the "Supreme Court's abandonment of its longstanding skepticism as to the suitability of contractually provided arbitration as a method for adjudicating commercial disputes otherwise appropriate for adjudication in court"); 352 n.22 (addressing the absence of statutes in Alabama and West Virginia providing for enforcement of arbitration agreements); 358 n.56 (noting that unequal bargaining strength is not an obstacle for compulsory arbitration); 358-59 n.61 (for the proposition that states can invalidate arbitration agreements upon the same grounds as for the revocation of any contract).

D. *Effect of Allied-Bruce Terminix Decision on Arbitration and Arbitration Agreements*

The long-term effects of the *Allied-Bruce Terminix* decision are not certain, but it seems clear that it has unalterably affected three areas of arbitration and the FAA. The first is the use of arbitration and arbitration agreements in general. The second is the way in which courts will interpret and apply section 2 of the FAA. The third is the effect on state arbitration statutes.

1. Arbitration in General

It is likely that the number of cases submitted to arbitration will continue to rise, as they have for the past few years.³⁴² Due to the *Allied-Bruce Terminix* decision, businesses will be more insistent in requiring and including arbitration agreements in contracts with consumers. Now that the hostility towards arbitration agreements, as evidenced by numerous state and federal courts, has been expressly condemned and forbidden by the holding, businesses will be more assured that a given arbitration agreement will be enforced. However, it is unlikely that the decision will have any substantial effect on the wording of the agreements or their placement in the contract. An agreement that does not include the words "interstate commerce" will still be enforceable against the parties if it "evidences a transaction involving commerce" as proven by the "commerce-in-fact" test.

Another reason for the increased number of cases submitted to arbitration is the increase in refusals to enter contracts containing arbitration agreements. The *Allied-Bruce Terminix* decision, while dispositive on the issue of section 2's applicability, carries no weight when the contract in dispute does not contain an arbitration agreement. The FAA only enforces voluntarily agreed upon arbitration agreements.³⁴³ It does not require arbitration in a contract evidencing a transaction involving

342. See *supra* note 15 and accompanying text.

343. 9 U.S.C. § 2 (1988).

commerce unless that contract contains such an arbitration provision.

2. Court's Analysis of Section 2 of the FAA

As discussed above,³⁴⁴ the lower courts have not questioned the holding in *Allied-Bruce Terminix*. It is likely that both the state and federal courts will continue to follow the reasoning of *Allied-Bruce Terminix* in analyzing cases involving section 2 of the FAA. It seems unlikely that section 2 can be expanded any more than it has been under the Supreme Court's analysis over the past fifty years. As has been the case with recent decisions, courts will spend less time establishing that a contract evidence a transaction involving commerce,³⁴⁵ reviewing instead the nature of the contract and the "grounds as exist at law or in equity for the revocation of any contract."³⁴⁶ This will be due to the speculated increase in arguments including contract revocation principles such as fraud in the inducement, duress, and unconscionability.

An interesting development to watch for is the possible decrease in section 2 cases actually being reviewed by courts. It is likely that arbitration agreements will indeed be more arbitrated than litigated, as intended by Congress in enacting the FAA. How this will affect section 2 of the FAA is unclear. Perhaps the current case law surrounding section 2 analysis and applicability will be dispositive on the subject. However, some lingering issues still need to be addressed by the courts. One such issue is whether sections 3 and 4 of the FAA, the procedural sections of the Act, are applicable in state court.³⁴⁷ As discussed above, the issue has been largely avoided by the Su-

344. See *supra* part V.B.1-3 (judicial reaction section).

345. *Columbus v. Kutzner*, 459 S.E.2d 422 (Ga. Ct. App. 1995); *Engalla v. Permanente Medical Group, Inc.*, 649 N.E.2d 1358 (Ill. App. Ct. 1995); *Mr. Mudd, Inc. v. Petra Tech, Inc.*, 892 S.W.2d 389 (Mo. Ct. App. 1995).

346. 9 U.S.C. § 2 (1988).

347. See *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 477 n.6 (1989); *Southland Corp. v. Keating*, 465 U.S. 1, 16 n.10 (1984); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 26 n.34 (1983). This point was also addressed by Justice Thomas in his dissent in *Allied-Bruce Terminix*. *Allied-Bruce Terminix*, 115 S. Ct. at 849 (Thomas, J., dissenting, joined by Scalia, J.).

preme Court in its prior decisions.³⁴⁸ If there is a decrease in section 2 cases being reviewed, this issue may remain unaddressed.

3. Effect on State Arbitration Law

The effect of the *Allied-Bruce Terminix* decision on state arbitration law is, in some respects, quite clear and, in other respects, ambiguous. Regarding state statutes holding arbitration agreements to be unenforceable in state courts,³⁴⁹ those statutes will be amended, superseded with new legislation, stricken from the states' codes, or simply left in the code and disregarded when a contract contains an arbitration agreement. State arbitration procedure laws will be dealt with differently. Aside from the section 3 and 4 issue above, the Supreme Court has given few insights as to whether state arbitration law will be preempted by the FAA. Generally, if the contract contains a choice of law clause, and the appropriate state arbitration law conflicts with the FAA and limits the enforcement of arbitration agreements, then the courts will apply the FAA.³⁵⁰ If the conflict does not affect enforcement of arbitration agreements, or broadens the scope of enforcement of arbitration agreements, the courts are likely to apply the more lenient state arbitration statute over the FAA.³⁵¹

The preemption of state arbitration law was addressed by Justice O'Connor in her concurring opinion in *Allied-Bruce Terminix*. Finding the broad application of section 2 "troublesome," Justice O'Connor posited that the broad reading of section 2 "will displace many state statutes carefully calibrated to protect consumers . . . and state procedural requirements aimed at ensuring knowing and voluntary consent."³⁵² The examples given, although written to protect the average consumer, will be displaced by the FAA in future cases.³⁵³

348. See *supra* note 212 and accompanying text.

349. ALA. CODE § 8-1-41(3)(1993); GA. CODE § 9-9-2(c)(9).

350. See *Allied-Bruce Terminix*, 115 S. Ct. 834, 843 (1995) (O'Connor, J., concurring).

351. See *Volt*, 489 U.S. 468 (1989).

352. *Allied-Bruce Terminix*, 115 S. Ct. at 843 (O'Connor, J., concurring).

353. The examples given by Justice O'Connor clearly involved statutes designed to protect the average consumer. The first example was MONT. CODE ANN. § 27-5-

VI. CONCLUSION

The *Allied-Bruce Terminix* decision broadened the FAA's ability to govern and enforce written arbitration agreements by extending its reach to the limits of Congress' Commerce Clause power. Arbitration has long been a popular avenue for parties to resolve disputes quickly and less expensively. Congress clearly intended for the FAA to ensure that arbitration remain a viable alternative in dispute resolution. The Supreme Court decided in *Allied-Bruce Terminix* that arbitration agreements shall be enforced whenever an "interstate commerce" connection can be made. And by adopting the "commerce-in-fact" test and laying to rest the "contemplation of the parties" test, many more arbitration agreements are reviewable under, and will be enforced through, section 2 of the FAA. This result accords with the very intent Congress had in enacting the FAA seventy years ago.³⁵⁴

Although the Court's treatment of the FAA has followed a general pattern of expansive interpretation, it left critical issues either unanswered or ambiguous. The decision in *Allied-Bruce Terminix* correctly addressed these issues and is dispositive on those matters. It is likely that the Supreme Court will continue to hold this expansive view of the FAA and the lower courts will apply it to contracts that pass the "commerce-in-fact" test. It is also likely that Congress will not amend or address any of the issues addressed in *Allied-Bruce Terminix*; relying instead on its holding to regulate the lower courts' and the States' application of section 2 of the FAA to arbitration agreements. Finally, as litigation costs increase, more contracts will contain arbitration agreements and more parties will employ the doctrines under section 2 of the FAA to resolve disputes surrounding those agreements.

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114(2)(b) (1993) which refuses to enforce arbitration clauses in consumer contract where the consideration is \$5,000 or less. *Id.* The second example was S.C. CODE ANN. § 15-48-10(a) (Supp. 1993) which requires that notice of arbitration provisions be "prominently" placed on the first page of a contract. *Id.* These statutes, although seemingly benign, will be preempted by the FAA. For an excellent discussion of the FAA's impact on state procedural law see Schumacher, *supra* note 31.

354. H.R. REP. NO 96, 68th Cong., 1st Sess. 1-2 (1924).

